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BY THE COMPTROLLER GENERAL

ORIGINAL

# Report To The Congress

OF THE UNITED STATES

COMPLETED

# Examinations Of Financial Institutions Do Not Assure Compliance With Consumer Credit Laws

Financial regulatory agencies' programs for enforcing consumer credit protection laws were inconsistent and, for the substantive aspects of some laws, inadequate. As a result, consumers have not been assured consistent protection, and financial institutions have not been treated equally.

GAO recommends that regulators modify their programs to emphasize the substantive principles of consumer credit laws. Regulators should reassess the objectives of compliance examinations, continue plans to recruit and train specialized examiners, adopt uniform detailed examination procedures, and establish uniform standards for enforcing compliance with consumer credit laws.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

Never in our history has access to credit been as important to individuals as it is today. Recognizing this phenomenon, the Congress has passed several laws in the past 12 years to protect consumers seeking credit.

This report discusses the Federal financial institution regulatory agencies' efforts to examine and enforce compliance with consumer credit laws. Generally, the agencies have not been as effective as they could have been in carrying out their regulatory responsibilities, particularly for the substantive aspects of consumer credit laws. However, there are a number of changes in process to strengthen the agencies' supervisory process. These changes should help to assure consumers that they will have a fair, equal chance of obtaining credit from the Nation's financial institutions.

We are sending copies of this report to the Director of the Office of Management and Budget, the heads of the five Federal financial institution regulatory agencies and interested Members and Committees of the Congress.

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

# EXAMINATIONS OF FINANCIAL INSTITUTIONS DO NOT ASSURE COMPLIANCE WITH CONSUMER CREDIT LAWS

## DIGEST

Consumer credit protection laws set forth basic principles to protect and inform consumers seeking credit. These principles include:

--Equal opportunity to obtain credit, free of discrimination by sex, race, color, religion, age, national origin, or marital status.

--Meaningful disclosure of terms and conditions of credit.

--Fair reporting and use of personal credit information.

--Fair debt collection practices.

--Reasonable efforts by financial institutions to help meet the credit needs of their local communities.

Financial institutions are responsible for complying with these laws. Financial institution regulators--the Federal Deposit Insurance Corporation, Federal Home Loan Bank System, Federal Reserve System, National Credit Union Administration, and Office of the Comptroller of the Currency--supervise institutions that extend credit such as banks, savings and loan associations, and credit unions. The regulators have responsibilities for ensuring that financial institutions comply with the laws so that consumers are afforded the protection provided by the laws.

GAO found that the agencies' programs for identifying violations and enforcing compliance with the laws were inconsistent and, for the substantive aspects of some laws, inadequate. As a result, consumers

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have not been assured consistent protection, and financial institutions have not been treated equally.

By focusing on technical compliance with only limited attention to substantive matters, regulators have fueled a longstanding controversy over consumer protection laws. Opponents of such laws say their costly requirements do not address the principles of the laws, while proponents contend that the basic requirements of the laws are not being enforced by regulatory agencies.

## INCONSISTENT AND INADEQUATE COMPLIANCE EXAMINATIONS

Agencies were not consistently or adequately examining financial institutions' compliance with some consumer credit protection laws. For the most part, agencies identified violations of technical requirements involving forms and disclosures, whereas violations of the substantive principles of some laws, such as discriminatory practices, were seldom cited. Agencies were also inconsistent in the laws chosen for compliance examination, the amount of effort expended on examinations, and the types and quality of analyses made during examinations.

In examining for compliance with consumer laws, agencies generally reviewed the stated policies of an institution, the forms it used, and how well it met the technical requirements of the laws. This approach was inadequate to validate compliance with the substantive principles of some consumer laws. For example, GAO found that the approach normally enabled agencies to adequately assess compliance with the principle of meaningful disclosure of terms and conditions of credit as required by the Truth in Lending Act. On the other hand, the approach hindered agencies in assessing compliance with such principles as equal credit opportunity and institutions' efforts to help meet local community credit needs.

Examinations for compliance with these requirements were generally inadequate.

Examiners performed few specific analyses to test institutions' practices (such as comparing accepted versus rejected loans) and generally only reviewed institutions' forms and talked to institutions' management.

## Consumers not assured protection of the law

The inconsistencies in agencies' examination programs resulted in differences in the number and type of violations identified. Assuming the identification of violations effects a change in an institution's policies, these differences ultimately affect the protection afforded to individuals seeking credit.

Weaknesses in agencies' methods of examining for compliance, particularly with regard to compliance with equal credit opportunity principles, prevent the agencies from identifying violations which should be corrected to assure consumers they will be treated in accordance with the law when seeking credit at a financial institution.

## AGENCIES NEED UNIFORM COMPLIANCE ENFORCEMENT STANDARDS

The enforcement of compliance with consumer laws varies by agency and by region within an agency. Agencies were generally not effective in obtaining compliance from institutions which did not voluntarily respond to verbal and written requests for corrective action.

GAO's sample of violations reported for 110 institutions showed that financial institutions voluntarily acted to correct violations brought to their attention by Federal regulators about 77 percent of the time. However, for 23 percent of the violations, institutions did not take corrective actions and the agencies generally did not take additional steps to enforce compliance. About one half of the institutions in GAO's sample continued to violate at least one provision of the laws from one examination to the next. Agencies' enforcement actions generally did not become progressively stronger, and they rarely used a cease and desist order to obtain corrective action.

GAO recognizes that since 1977 the agencies have made substantial progress in correcting these shortcomings, and momentum for improvement continues. Uniform guidelines have been adopted to examine for and enforce compliance with some laws. More changes are needed, however, if the agencies are to achieve the level of supervision needed to assure consumers the protection provided for in the laws. A task force to assess consumer examination was recently established by the Comptroller of the Currency. GAO believes the task force's goals provide an excellent framework for all of the agencies to consider needed changes.

## RECOMMENDATIONS

The Chairmen of the Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, Federal Reserve Board, and National Credit Union Administration and the Comptroller of the Currency should work together, under the direction of the Federal Financial Institutions Examination Council, to develop and administer consistent, effective consumer law compliance examination programs that adequately address the substantive principles of the laws. Specifically, the agencies should:

--Reassess the nature and objectives of compliance examinations.

--Place greater training emphasis on examination techniques that assess substantive principles of the laws and regulations.

and regulations.

- --Develop uniform examination procedures for all consumer protection laws to effectively assess compliance with the substantive as well as the technical provisions of consumer laws.
- --Determine and allocate the level of resources necessary to effectively implement uniform examination procedures.
- --In the case of the Federal Home Loan Bank System, establish separate career paths for consumer law compliance examiners.

The Federal Financial Institutions Examination Council should monitor the progress of the Comptroller of the Currency's task force on consumer examination to determine the applicability and value of such a review for the other financial institution regulatory agencies.

The agencies should establish uniform standards for enforcing compliance with consumer laws, recognizing the varying significance of violations, and stating clearly the penalties that will be applied consistently for noncompliance. These standards should be transmitted to the financial institutions.

## AGENCY COMMENTS

The agencies and the Examination Council generally agreed with GAO's recommendations. Since the completion of the review, the agencies, individually and under the direction of the Examination Council, have initiated several actions to improve their examination programs and to establish uniform enforcement standards.

Specific agency comments are incorporated as appropriate throughout the report and presented in total in appendixes III through VIII.

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# ABBREVIATIONS

| | |
|---|---|
| CRA | Community Reinvestment Act |
| ECOA | Equal Credit Opportunity Act |
| FDIC | Federal Deposit Insurance Corporation |
| FHA | Fair Housing Act |
| FHLBS | Federal Home Loan Bank System |
| FRS | Federal Reserve System |
| HMDA | Home Mortgage Disclosure Act |
| NCUA | National Credit Union Administration |
| OCC | Office of the Comptroller of the Currency |
| TIL | Truth in Lending |

# CHAPTER 1

## INTRODUCTION

In response to a rapid increase in consumer credit and examples of unfair treatment of consumers, the Congress beginning in 1968 enacted a series of laws designed to inform and protect consumers seeking credit. Consumer credit protection legislation covers a broad range of consumer credit matters and embodies certain basic principles, including meaningful disclosure of finance terms and conditions, equal credit opportunity, fair credit reporting practices, and institution lending practices to meet community needs.

Several Federal regulatory agencies are responsible for enforcing the laws. The Federal financial institution regulatory agencies--the Federal Deposit Insurance Corporaction (FDIC), the Federal Home Loan Bank System (FHLBS), the Federal Reserve System (FRS), the National Credit Union Administration (NCUA), and the Office of the Comptroller of the Currency (OCC)--supervise most of the nation's financial depository institutions, including banks, savings and loan associations, and credit unions. These agencies have responsibilities for ensuring that these institutions comply with the laws. Generally, the Federal Trade Commission is responsible for enforcing compliance with the laws by commercial nondepository credit and retail institutions, including finance companies, commercial retail operations, and most mortgage companies.

From 1960, when this type of consumer legislation was first proposed, up to the present, consumer credit protection laws have been a source of continued controversy. While there is general agreement on the basic principles underlying the laws, consumers and creditors have expressed dissatisfaction with the complex and burdensome requirements of the laws and of the implementing regulations. Consumer advocates have expressed dissatisfaction with creditors' efforts to comply with the laws and with Federal agencies' actions to enforce compliance with the laws. Recognizing the difficulties and burdens of the Truth in Lending (TIL) Act, the Congress in March 1980 amended the law in an effort to eliminate some of its complexities and focus more on its basic principles.

## SEVERAL LAWS ENACTED IN LAST 12 YEARS TO PROTECT CONSUMERS' CREDIT RIGHTS

Consumers' increasing reliance on credit and congressional concerns that consumers were not treated equally and fairly when seeking credit prompted the enactment of several consumer credit protection laws in the last 12 years. The laws were enacted piecemeal and cover a broad range of matters affecting the extension of credit. Federal supervision of compliance with the laws is dispersed among 16 Federal agencies with the financial institution regulators having major responsibility.

The first of the new laws, the Truth in Lending Act (TIL), was passed in 1968. The Congress acted upon evidence showing examples of finance charges stated in confusing or misleading terms and of consumers not knowing the real cost of credit, thus precluding their shopping for credit. TIL sought to eliminate this confusion by requiring a meaningful disclosure of credit charges.

In the same year, the Civil Rights Act of 1968 was passed, including Title VIII, the Fair Housing Act (FHA). The Fair Housing Act and subsequent fair lending legislation require creditors to use the same criteria to evaluate prospective borrowers regardless of race, color, religion, sex, marital status, age, or national origin.

Since 1968, additional legislation has been enacted which is intended to protect consumers engaging in credit transactions. Most of these laws were enacted in the last 5 years. A summary of consumer credit protection legislation appears in appendix I.

## FEDERAL ENFORCEMENT RESPONSIBILITY DISPERSED AMONG 16 AGENCIES

Integral to the enactment of consumer credit legislation is the specific or asserted responsibility for Federal enforcement of such laws including the authority to enforce compliance. Some laws, such as TIL, the Home Mortgage Disclosure Act (HMDA), and the Community Reinvestment Act (CRA) are specific as to which agencies are responsible for enforcement and the extent of their authority. Other laws, such as the FHA, the Flood Disaster Protection Act, and the Real Estate Settlement Procedures Act, do not explicitly identify the responsible agencies.

Because the Federal regulatory structure is decentralized and because the consumer laws apply to a number of different federally regulated industries, 16 Federal regulatory agencies are responsible for enforcing one or more of the consumer credit laws. The five Federal financial institution regulatory agencies supervise the principal extenders of credit and have responsibilities for enforcing the majority of laws. A summary of Federal regulatory responsibility for each law is shown in appendix II.

Enforcement of the laws is managed on an agency-by-agency basis. No agency or group in the Federal government coordinates the enforcement activities of all the agencies. However, the Federal Financial Institutions Examination Council serves as a focal point to coordinate the activities of the five financial regulatory agencies.

We did not assess the level of effort expended by each of the 16 agencies; however, the five financial institution regulatory agencies are unlike most other regulators because they regularly examine for compliance. The Federal Trade Commission, the other agency with major responsibilities for enforcing compliance with consumer laws, depends primarily on the consumer complaint process to direct its enforcement program.

Financial institution managers are aware of the different levels of supervisory effort expended by the various regulatory agencies and complain that they are being supervised more severely than competitive creditors such as finance companies and retail merchandisers. Financial institution managers cite increased costs because of regulatory examinations and because of requirements to comply with consumer laws when many of these competitors are not regularly examined and cited for noncompliance.

## OBJECTIVE, SCOPE, AND METHODOLOGY OF REVIEW

We made this review to assess the consistency and effectiveness of 5 financial regulatory agencies' compliance programs in implementing the following 13 consumer credit protection laws:

--Truth-in Lending (Regulation Z).

--Fair Housing.

--Fair Credit Reporting.

--Flood Disaster Protection.

--Equal Credit Opportunity (Regulation B).

--Fair Credit Billing.

--Home Mortgage Disclosure (Regulation C).

--Consumer Leasing.

--Real Estate Settlement Procedures (Regulation X).

--Fair Debt Collection.

--Community Reinvestment.

--Electronic Funds Transfer (Regulation E).

--Right to Financial Privacy.

The financial regulatory agencies involved in this study included: Federal Deposit Insurance Corporation, Federal Home Loan Bank System, Federal Reserve System, National Credit Union Administration, and Office of the Comptroller of the Currency. Our audit work was performed between March and November 1979 at the agencies' Washington, D.C. headquarters offices and at 11 field offices in 6 locations: Atlanta, Ga; New York, NY; Harrisburg, Philadelphia, and Pittsburgh, Pa; and Richmond, Va.

We reviewed agencies' written consumer policies, procedures and guidelines and discussed consumer examination procedures, enforcement programs, staffing policy and training with headquarters and regional officials. We statistically selected 550 institutions and reviewed the three most recent consumer reports to determine examination dates, type, time spent, number of examiners and assigned rating. For 6 of the more significant laws, we statistically selected and analyzed reports, workpapers and correspondence for 140 institutions--110 completely and 30 for selected provisions of the laws--to assess examination procedures and their adequacy. We also examined reports and correspondence of 36 institutions identified specifically as having consumer enforcement problems.

We judged adequacy based on whether the work performed by the examiners was sufficient to support a determination of compliance or noncompliance with the consumer credit protection laws.

Our findings of inadequacy are based on a 95 percent level of confidence that at least 20 percent of the examinations were inadequate to ascertain compliance or noncompliance with the particular provision cited. Our audit results reflect the practices of the regions we visited, which may or may not reflect the agencies' practices as a whole.

To substantiate our analytical findings, we accompanied each agency's examiners on at least one examination and observed first hand the examination techniques employed. In each instance, the agency selected the institution and examiners for our observation. Our participation in these examinations was limited by the agencies to observing examiners' activities only; we were not permitted to attend examiner/banker conferences. We could not independently test the effectiveness of agencies' examinations through first hand review of institutions' records because the agencies would not allow us to perform independent onsite consumer law examinations.

## Substantive and technical compliance

Throughout the report we refer to the concept of substantive and technical compliance. By substantive we mean the basic principles of the laws. By technical we mean specific technical requirements of the law or regulation. For example, the substantive principle of the Equal Credit Opportunity Act (ECOA) is that all individuals have an equal opportunity to obtain credit, free of discrimination by sex, race, color, religion, age, national origin or marital status. The law specifically prohibits credit discrimination on these bases. An institution could achieve technical compliance with ECOA by, among other things, not requiring prohibited information such as marital status, child-bearing intentions, and race on the credit application form. However, to fully achieve substantive compliance the institution also would have to make credit decisions using consistent lending criteria that do not discriminate against borrowers on these factors. Technical compliance enhances, but does not assure, complete compliance with the law. However, violations of technical requirements may be indicative of a substantive violation.

The agencies have not uniformly defined substantive and technical compliance and there is disagreement as to what provisions of the laws or regulations constitute each type of compliance. We recognize the uncertainties in this area and as such do not suggest that our definitions are all inclusive. We believe, however, those provisions that we identify as substantive would be included as such in any uniform delineation of substantive and technical compliance.

# CHAPTER 2

## AGENCIES' EXAMINATIONS SHOULD PLACE GREATER EMPHASIS ON LAWS' SUBSTANTIVE PRINCIPLES

The Federal financial institution regulatory agencies, unlike most other regulators, regularly examine financial institutions' records and procedures for compliance with consumer credit protection laws. The agencies' examination programs need to be improved, however, because they are inconsistent and inadequate for determining compliance with the substantive principles of some of the laws. Consumers are not assured consistent protection under the law and financial institutions are supervised unequally.

The agencies' emphasis on technical compliance in lieu of substantive compliance stems from their early failure to meet their responsibilities for assuring compliance with consumer laws including developing expertise and specific examination procedures for substantive issues. The agencies are taking important steps to improve the assignment and training of examiners but they need to establish one uniform examination program which addresses the substantive principles as well as the technical requirements of the laws.

## AGENCIES NOT CONSISTENTLY OR ADEQUATELY EXAMINING INSTITUTIONS' COMPLIANCE

The agencies are not consistently or adequately examining financial institutions' compliance with consumer credit protection laws. The agencies' reports and workpapers primarily identified violations of forms and disclosures; violations of the substantive principles of the laws, such as discrimination, were seldom cited. We found that the agencies were not always examining for compliance with the same laws, varied on the amount of effort expended, and performed different types and quality of analyses including consideration of different information. In our opinion, the examinations were not adequate to assess institutional compliance or noncompliance with substantive provisions of the ECOA, FHA, and CRA. Also, we found indications that FHLBS might not adequately evaluate annual percentage rate calculations and other provisions of TIL.

### Agencies slow in meeting consumer compliance responsibilities

When the first consumer credit protection legislation was passed in 1968, the agencies were not prepared to accept this new responsibility. The financial regulatory agencies were created to ensure financial safety and soundness. The agencies recruited, organized, and trained staff to examine the financial safety and soundness of regulated institutions. Consumer credit protection legislation established responsibilities that differed from the agencies' traditional financial responsibilities. The legislation caused concern among the agencies because:

- --Managers' and examiners' experience was in financial matters.
- --Agencies' charters established safety and soundness as the primary purpose of the examination process.
- --Consumer laws, quite simply, were something new.

Some managers and examiners who might have been responsive said they received little or no encouragement from top management. For instance, prior to late 1976, examiners and managers received little, if any, training in consumer compliance matters and received only limited procedural guidance. This was 8 years after the enactment of TIL.

In some ways, consumer credit protection laws were in sharp contrast with traditional safety and soundness assessment criteria. No set standards exist for assessing many aspects of financial soundness, and judgment, using traditional informal criteria, is required. Some traditional, time-honored criteria were markedly different from requirements established by consumer credit protection legislation. For example, while the 1968 FHA prohibited racial and other discrimination, the law could not readily change historical belief stated as recently as the early 1960s that mixing social and racial classes would affect neighborhood stability and ultimately the quality of loans made in such areas.

Consumer legislation required examiners to consider the form and basis of financial transactions, as well as their quality or likelihood of repayment. It was difficult for examiners and managers to grasp the importance of this new responsibility. During our review, some managers and examiners commented that financial safety and soundness was the principal responsibility of their agencies and that consumer law compliance was of lesser importance. As recently as 1979 in a survey of FRS, OCC and FDIC managers and examiners, as part of an FDIC study on Federal-State bank examinations, compliance with consumer protection laws and regulations was considered to be the least important aspect of examination in a list of 11 examination functions.

New responsibilities for enforcing consumer law compliance were perceived by some agency examiners as requiring a new role and relationship with institutions. The relationship that had evolved over the years in the safety and soundness area in many cases was that of consultant/adviser. The enactment of consumer legislation angered many financial institution managers, and agency efforts to examine and enforce legislation often were not well received. We were told by bank examiners detailed to consumer law compliance duty that they were concerned, because of bankers' responses, that consumer law compliance examinations would weaken good relationships they had established. Thinking this could result, some examiners were less likely to be aggressive in their compliance role particularly when it was only for a 6-month temporary tour of duty.

Finally, consumer laws were new and meant change--not just one change but rather continual addition and modification of laws and regulations for the past 12 years. Even beyond the resistance to change, the newness meant establishing and experimenting with new programs in an effort to best accommodate the new changes. Most of this did not start seriously, however, until after a number of new requirements were instituted in 1975-1976.

While it is not possible to determine the extent to which each of these factors affected the agencies' programs, our discussions and the results of the FDIC survey show that concerns existed. With the passage of time, the addition of new people and improved training many of these concerns have been overcome or modified in the agencies. But we believe these factors slowed the agencies' acting to meet their responsibilities for assuring compliance with consumer laws and thus contributed to the weaknesses that exist in the agencies' examination programs.

## Inconsistencies

Our analysis of the most current examination reports for 500 institutions and supporting workpapers for 140 institutions in 11 regional offices showed that the agencies, and regions within agencies, varied on the number of laws addressed, from 9 to 12; the amount of effort expended examining, from an average of 18 hours or less to 104 hours per examination for the most recent examination; the type and quality of analyses performed (ranging from none to detailed analytical schedules) and the use of different numbers of cases and types of data. While many of the inconsistencies were by agency, other inconsistencies related to regional or individual examiner differences.

In a typical examination, we found that the agencies, depending on the region, addressed from 9 to 12 of the 13 laws we considered. Most longstanding legislation, such as TIL, FHA, Fair Credit Reporting Act, ECOA, and HMDA, as well as the newer CRA were addressed by all agencies and regions except NCUA which is not responsible for CRA. Some laws such as the Flood Disaster Protection Act, Fair Debt Collection Act, and Consumer Leasing Act, were addressed by most, but not all, agencies and regions. Almost uniformly, the agencies did not address the applicable provisions of the relatively new Electronic Funds Transfer Act; and the Right to Financial Privacy Act, for which there is no specified supervisory responsibility.

The amount of effort each of the agencies expended examining for compliance with the consumer laws was different. In our sample of 500 institutions for the most current comprehensive or full scope examinations, the average time spent examining an institution ranged from 18 hours or less for NCUA and 28 hours for FHLBS to 102 and 104 hours for FRS and OCC. In some instances, there were significant differences among regions within agencies. For example, FDIC-Atlanta averaged 17 hours for the most recent full-scope compliance examinations, while FDIC-Philadelphia and Richmond averaged 106 and 108 hours, respectively. While asset size of institutions could account for some of this difference among the FDIC regions, our analysis showed the same regional relationships to be true regardless of asset size.

The amount of effort expended examining for specific laws varied also. For example, from the most recent examination report for 296 institutions for FDIC, FHLBS and FRS (OCC and NCUA did not accumulate time by regulation) we found that FRS spent an average of 50 hours examining TIL as compared to 33 hours for FDIC and 3 hours for FHLBS. For CRA, based on 67 reports, the three agencies, using uniform guidelines, spent about the same amount of examination time: FDIC, 14 hours; FRS and FHLBS, 18 hours. For ECOA, for 302 reports, time spent varied from about 5 hours for FHLBS to 16 hours for FRS.

While we thought there might be a relationship between time spent and violations cited, a comparison among agencies and by agency from one examination to the next showed differing relationships between the number of hours expended and the number of different violations reported. We analyzed examination reports and workpapers for 110 institutions--10 for each of the 11 offices we visited. For FDIC's most recent examinations of 10 institutions in 3 regions, as the average number of different hours spent increased from 21 to 94 to 192 the average reported violations also increased from 4 to 7 to 9.

However, for FRS's most recent examinations one district spent 166 hours and found 13 different violations while another district spent only 93 hours but still found 13 different violations. The following chart shows our findings relative to time spent and violations reported for these 110 institutions.

Average Hours Spent and Violations Reported By Agency for 10 Institutions in Each Region

| | Most recent examination | | Second most recent examination | | |
|---|---|---|---|---|---|
| Agency and region | Hours | Different violations | Hours | Different violations | Average assets (millions) |
| **FDIC** | | | | | |
| Atlanta | 21 | 4 | 14 | 3 | $ 19 |
| Philadelphia | 94 | 7 | 74 | 10 | 101 |
| Richmond | 192 | 9 | 110 | 6 | 156 |
| **FHLBS** | | | | | |
| New York | 34 | 1 | N/A | 1 | 100 |
| Pittsburgh | 48 | 3 | N/A | 3 | 69 |
| **FRS** | | | | | |
| Atlanta | 166 | 13 | 109 | 13 | 195 |
| Richmond | 93 | 13 | 24 | 5 | 114 |
| **OCC** | | | | | |
| New York | 86 | 11 | 39 | 10 | 100 |
| Richmond | 92 | 10 | 41 | 6 | 39 |
| **NCUA** | | | | | |
| Atlanta | a/40 | 1 | a/45 | 3 | 6 |
| Harrisburg | a/36 | 2 | a/29 | 1 | 1 |

a/Combined commercial and consumer.

Although we did not perform an indepth analysis to establish reasons for these variations, the agencies suggested the variations can be attributed to such things as:

--The institutions' size.

--The institutions' commitment to compliance.

--The existence of a compliance officer.

--The type of loans offered.

--The number of violations discovered.

The agencies did not suggest, however, the extent to which each of these factors could or should specifically relate to time spent examining.

An analysis of time spent on examinations in relation to the average asset size of the institution examined for these 110 institutions showed that for three agencies the time spent increased with increases in asset size. This was not true for OCC and FHLBS.

We were told by several sources that the smaller institutions were generally having greater difficulty implementing consumer credit legislation than were larger institutions. The principal reason given was that larger institutions could better afford the special expertise needed to implement and monitor consumer legislation. However, except for FHLBS, the number of violations reported decreased as average asset size decreased.

The OCC comments that our findings are not necessarily incompatible with the statement that smaller institutions are having more difficulty with the law. They suggest that smaller institutions originate less complicated and fewer types of loans and are therefore cited for fewer violations. They believe, however, that the violations for which smaller institutions are cited are generally more serious while larger institutions have more opportunities to make technical errors.

## Variations in the type and quality of analyses performed

Our review of agencies' procedures, examination of workpapers for 140 institutions, and observation of 6 examinations by the 5 agencies showed that agency requirements and examiners' actions differed on the information considered and on the type and quality of analyses performed when examining for compliance.

Financial institutions are required by law and regulation to maintain specified documentation. These documents contain some of the information examiners need to assess an institution's compliance with the laws. For example, the institutions must maintain: accepted and rejected loan application files; race, sex, and national origin monitoring information for mortgage loan applications; HMDA statements, for institutions in metropolitian areas detailing by area the number and value of home related loans; and CRA statements, except for credit unions, outlining the institutions' lending policies. Also, institutions should have copies of blank forms they would use to comply with provisions of certain laws, such as adverse action notifications for ECOA and good faith estimate forms for the Real Estate Settlement Procedures Act.

Examiners' use of this type of data differed considerably. For example, for rejected loan files, we noted variations in examination techniques from (1) assuring that the institution maintained such files, (2) checking to make sure adverse action notices were sent, (3) checking the reason for credit denial against established loan policies, to (4) scheduling race, sex, and age information, with support from monitoring information, and comparing to accepted loans.

Use of Home Mortgage Disclosure statements by examiners, among and within agencies, varied from (1) not considered, (2) noted as on hand, (3) verified for technical compliance, (4) analyzed to check for discrimination, to (5) analyzed in comparison with CRA statements to verify compliance with CRA. Monitoring data maintained for home loans for ECOA and FHA was treated similarly.

For provisions of TIL, there were variations in the workpapers in obtaining or not obtaining copies of erroneous forms, selecting and listing samples, and listing data and data computations.

### Inadequacies in examinations

The agencies' examinations broadly cover all laws emphasizing evaluation of institutions' stated policies, forms and technical compliance with the laws. The examinations generally addressed substantive aspects of TIL because the nature of such examinations is mathematical and readily observable. The agencies' examinations of the more difficult to assess and more time-consuming substantive principles of ECOA, FHA uniformly inadequate. Examiners performed few analyses of accepted versus rejected loans and generally only reviewed institutions' forms and talked to institutions' management.

We reviewed examination reports and workpapers for 140 institutions, discussed examination techniques and other compliance matters with more than 50 examiners and managers and observed 6 examinations in progress to determine the adequacy of agencies' examinations. We evaluated the type of analyses performed by the agencies for most provisions of six laws--TIL, Fair Credit Reporting, ECOA, FHA, HMDA and CRA, and judged whether we thought the analysis was sufficient to assess compliance with the laws.

Generally, we found the examination to be adequate for verifying technical and disclosure requirements such as:

Truth in Lending

--Sec. 226.6a, requiring the terms "finance charge" and "annual percentage rate" to appear more conspicuously;

--Sec. 226.7 and 226.8, requiring specific disclosures for open and closed end credit; and

--Sec 226.9, requiring notification of right to rescission for loans collateralized by a lien, mortgage or other security interest on an individual's home.

Fair Housing

--displaying Fair Housing Lending poster; and

--including Fair Housing logo on advertising correspondence.

We found indications that the agencies were also adequately examining technical and disclosure requirements for:

--Home Mortgage Disclosure Act provisions for identifying institutions subject to preparing HMDA reports.

--Community Reinvestment Act provisions requiring delineation of lending community, a statement of specific types of credit extended, and maintenance of a public comment file.

For HMDA and CRA, our sample results were indicative of the agencies' practices but insufficient to be statistically conclusive because HMDA applies to only those institutions in Standard Metropolitan Statistical Areas and CRA was relatively new legislation.

For the substantive provisions of TIL such as 226.4, the accuracy of the finance charge determination, and 226.5, the accuracy of the annual percentage rate, we generally found that the agencies' examinations were adequate. However, during our observation of an FHLBS examination, we noted that the examiner did not know how to correctly verify the accuracy of the annual percentage rate calculation for a particular loan. We could not determine to what extent this was representative of FHLBS' examinations because we were not permitted to independently test institutions' compliance. However, as the FHLBS points out in its comments, subsequent to our audit, programmable calculators were obtained to help examiners determine compliance with TIL requirements.

For the substantive principles of ECOA and FHA, regardless of time spent, we generally found the agencies' examinations to be inadequate for determining compliance. From our limited sample for CRA, we found indications that examinations were inadequate to determine substantive compliance or noncompliance. The specific provisions of the laws for which we found examinations inadequate were:

--ECOA, which states that a creditor shall not discriminate against an applicant on the basis of race, color, sex, age, religion, national origin or marital status.

--FHA, which states that it is unlawful to deny credit for the purchase or improvement of a dwelling on the basis of race, color, religion, sex or national origin.

--CRA, which requires assessment of institutions' performance to comply with the Act.

We also found the agencies generally did not verify the accuracy of HMDA data.

Our conclusions are based principally on the lack of documented analysis, such as a comparison of rejected loans to accepted loans, analysis of monitoring information for real estate related loans, and the use of HMDA data for geocoding (plotting approved loans on a delineated map of the institution's community) to assess CRA. Our conclusions were reinforced by discussions with examiners who believed more effort was needed to assess compliance with fair lending laws such as ECOA and FHA and by our observations of six actual examinations.

Discriminatory practices can be difficult to detect, but without some analysis of the available data--which the institutions are required to maintain--even a tentative examiner conclusion on substantive compliance is hard to reach. Without some analysis, it is difficult to determine, for example, what percentage of white married males were granted loans as opposed to single white males or females, or minorities; and what the rejection rates were for these various categories. Analyses such as these provide the first step to surfacing problems that might exist.

Some examples of the analysis supporting agencies' conclusions on ECOA, FHA, and CRA are as follows.

To assess the examination for compliance with ECOA, we found:

--A check mark on a pro forma worksheet supported by another worksheet describing the examiner's review of application forms. The examiner cited the institution for improper requests of other income information and in a previous examination cited the institution for improper requests for marital status and cosignature requirements.

--A check mark on a pro forma worksheet supported by another worksheet describing the examiner's discussions with institution management and review of loan policies. There was no comparison of accepted loans to rejected loans, no use of monitoring information, and no ECOA violations cited.

In a few cases included in our sample, we found examiners performing indepth reviews including (1) talking to management, (2) reviewing loan policies, (3) comparing reasons for rejection to stated loan policies, (4) comparing accepted and rejected loans, and (5) scheduling monitoring information to discern trends. However, these examinations were the exceptions to what we normally found.

For the FHA, we most often found a checkmark indicating no discrimination, or there was no mention of Fair Housing, which indicated compliance. As with ECOA, there was little evidence to support the conclusion. Often monitoring data was not maintained by institutions or, if available, was not used by the agencies to evaluate for discrimination.

In a few instances, we did find examiners who plotted the location of rejected mortgage applications on area maps and scheduled monitoring information to identify possible trends of noncompliance.

Our conclusions on the CRA must be qualified because the law was recent and an insufficient number of examinations were performed to statistically validate our findings. In most of the cases we reviewed, however, the examiners were generally not taking steps to assess institutions' performance. The examiners focused on the availability of a CRA statement and on some assessment of the statement. We did note some examiners using HMDA data to plot approved loans on a map of the institutions' delineated community. In no instances did we find examiners using data other than institution records to assess compliance. For example, no discussions were held with community groups or leaders to determine needs and institutions' efforts to meet these needs.

Based on our review of examination reports for 110 institutions and supported by the agencies' overall statistics, very few substantive violations of ECOA, FHA, and CRA were identified in the most recent examinations. Defining substantive violations as those which discriminate against applicants on one of the prohibited bases or fail to help support community lending needs, we found that the number of ECOA, FHA, and CRA substantive violations were small in comparison to the substantive violations of TIL and as a percent of all violations. TIL substantive violations, for the purpose of this example, included incorrect annual percentage rate calculations and erroneous finance charge disclosures. The chart below shows the violations identified in the 110 institutions in our sample for the most recent examinations.

### Analysis of Violations for Most Recent Examinations of 110 Insitutions

| | Total | Technical | Substantive | | | |
|---|---|---|---|---|---|---|
| | | | TIL | ECOA | FHA | CRA |
| Number | 720 | 641 | 77 | 1 | 1 | 0 |
| Percent | 100 | 89 | 11 | 0 | 0 | 0 |

In our sample, substantive ECOA and Fair Housing violations included only two violations--prescreening and suggested age discrimination--out of a total of 720 total violations. We noted another 35 violations that had substantive implications including obtaining and maintaining prohibited information and requiring cosignatures for loans.

The agencies' overall statistics for 1979 reflected the same general relationships. The chart below shows the violations identified nationwide by the three banking agencies in 1979. We have been unable to obtain comparable data for FHLBS and NCUA.

### Analysis of Violations Cited by the Three Banking Agencies in 1979

| | Total | Technical | Substantive | | | |
|---|---|---|---|---|---|---|
| | | | TIL | ECOA | FHA | CRA |
| Number | a/104,941 | 93,021 | 11,724 | 196 | b/4 | 0 |
| Percent | 100 | 91 | 9 | 0 | 0 | 0 |

a/Examinations for about 7,000 institutions.
b/Only FDIC information was available.

## AGENCIES' EXAMINATIONS NEITHER ASSURE PROTECTION OF CONSUMERS' RIGHTS NOR PROVIDE EQUAL SUPERVISION OF INSTITUTIONS

Because of the agencies' examination differences and inadequacies, consumers are not assured of equal and effective protection when seeking credit from financial institutions. At the same time, financial institutions are supervised unequally because of differences among the financial institutions' regulators.

The agencies' examination programs differ in the number of different types of violations identified (as shown on p. 10). Assuming the identification of violations affects a change in an institution's policies, these differences ultimately affect the protection afforded to individuals seeking credit. Because of examination inadequacies, however, there are no assurances of protection by any institution for some provisions of the law. Also, as shown in the next chapter on enforcement, identifying a violation does not necessarily mean the practice will be corrected. But clearly if a violation is not identified, the possibility of correction is lessened.

Financial institutions because of differences among the regulatory agencies, are similarly treated unequally; some institutions are examined more extensively than others. Institutions that are not examined as prudently may not be apprised of inappropriate practices and thus may be vulnerable to suits from customers or applicants. Institutions trying to circumvent the law may be allowed to continue such practices. While primary responsibility for compliance lies with the institution, for smaller institutions, which because of location do not have access to professional advice, or because of financial size cannot afford it, quality examination and advice is important.

In this respect the educational efforts of each of the agencies is helpful. All of the agencies through various publications have attempted to educate institutions on their compliance responsibilities. The FRS, with perhaps the most sophisticated program, provides educational seminars to all FRS member banks upon request. The FDIC also has a program to provide one-day educational seminars to assist bankers in meeting their compliance responsibilities.

Finally, the agencies' current focus on technical and disclosure matters fuels the controversy between proponents and opponents of consumer legislation. By emphasizing the technical aspects of the laws and regulations in the examination process, the agencies support opponents' concerns of costly and unnecessary requirements that go beyond the basic principles. Focus on the technical lends support to proponents' concerns that the laws' basic requirements are not being enforced by the regulatory agencies.

## EXAMINATION WEAKNESSES STEM FROM LACK OF COORDINATION AND AGENCIES' INADEQUACIES IN STAFFING, TRAINING, AND EXAMINATION PROCEDURES

The agencies' examination programs are inconsistent because the agencies have not coordinated a uniform approach to examination. The programs focus primarily on technical requirements, which are easier to assess, and are inadequate to assess the substantive principles of some laws. This type of program exists because the agencies have not (1) effectively staffed examinations of consumer law compliance, (2) adequately trained examiners in consumer compliance, and (3) developed adequate examination procedures or, when seemingly adequate procedures have been developed, have not required examiners to use them. Emphasis on safety and soundness and an early lack of commitment to consumer law compliance by the agencies contributed to the weaknesses that exist today. All of these factors contribute to the agencies' inconsistencies and inadequacies, and even though we address each one separately below, it should be recognized that the factors are intertwined and a clear delineation of cause was not always apparent.

### Lack of coordination

For consumer law compliance, as in most other areas of examiniation until recently, the agencies established and carried out their own individual programs. There was no formal coordination of examination procedures, examiner staffing, examiner training, examination frequency or any other aspect of consumer law compliance examination. The agencies in the last 2 years, however, have attempted to coordinate selected aspects of the examination programs including issuing uniform guidelines for CRA and uniform enforcement standards for TIL. Under the direction of the Federal Financial Institutions Examination Council, additional attempts to uniformly examine and enforce certain laws are ongoing and the agencies are finalizing a uniform examiner training program. Experience with uniform CRA guidelines and the initial TIL enforcement standards demonstrated that issuing uniform statements does not ensure uniform program implementation, but the agencies' efforts should be recognized as desirable attempts to better coordinate their programs.

### Staffing policies have prevented the development of an experienced, committed examiner force

The agencies' policies for assigning responsibility for examining compliance with consumer laws have been inappropriate for developing experienced, committed consumer examiners and have contributed to examination inconsistencies and inadequacies. Until 1979, safety and soundness examiners were generally detailed to consumer law compliance examination for 6 months or were assigned consumer examination responsibilities in conjunction with the safety and soundness examination. There was little specialization in consumer compliance examination. Examiners did not have the time or incentive to become experienced, committed consumer law compliance examiners. In 1979, the three banking agencies--FDIC, FRS and OCC--moved to change this by establishing separate consumer examiner career paths. In January 1980, NCUA instituted the same policy. FHLBS continues to assign consumer examination responsibilities in conjunction with the safety and soundness examination.

Several consumer laws were enacted before the banking agencies instituted separate consumer examinations. When the first consumer laws--TIL and Fair Housing--were implemented, the agencies incorporated TIL into their safety and soundness examination. The agencies did not immediately assume responsibility for examining Fair Housing. As new laws were enacted in the early 1970s, the agencies expanded their safety and soundness examination to incorporate these laws. As the number of laws kept increasing, the banking agencies in 1976 and 1977 acted to establish separate consumer law compliance examinations. NCUA and FHLBS continued to include consumer examination in the safety and soundness sumer law compliance examinations. NCUA and FHLBS continued to include consumer examination in the safety and soundness examination. Until recently, none of the agencies emphasized the commitment of resources to consumer compliance examination.

When the banking agencies established separate consumer examinations, they assigned examiners on a full-time basis for 6 months to perform the examinations. Most of the bank examiners we interviewed had examined under this concept and several thought the process to be unsatisfactory, even with the improved training that was initiated in 1979. Some comments from the 20 examiners we interviewed included:

--It takes at least 6 months to learn the area.

--There should be a minimal detail of at least 18 months or 24 months.

--If there was more continuity, fewer examiners would be required.

--By the time an examiner becomes competent with various consumer laws and regulations, it is time to rotate back to the commercial examination program.

One examiner expressed the opinion that

--if he was only on consumer detail for 6 months, he would be reluctant to criticize bank managers for consumer law compliance if he had to return to examine the bank for safety and soundness for several years to come.

The general feeling was that the laws were too complex to competently understand and proficiently examine in 6 months. Another concern expressed by examiners and managers was that the examiners did not have enough time or expertise to adequately examine for discrimination. Because of limited staff, limited expertise and efforts to maintain a 12- or 18-month examination cycle, the agency field offices encouraged broad but limited examination of compliance with all consumer laws.

Until January 1980, when NCUA announced a new program of specialized consumer examinations, NCUA and FHLBS performed a combined safety and soundness and consumer compliance examination. This examination policy also posed difficulties in developing experienced, committed examiners. In an environment emphasizing financial safety and soundness, consumer law compliance examination received secondary status. Responsibility for examining compliance was rotated among examiners from one examination to the next precluding examiner continuity. In a time-constrained situation, consumer law examination did not receive highest priority resulting in uneven examination and experience for examiners.

Most examiners and managers of all agencies agreed that separate compliance examinations and specialized consumer examiners assured a higher quality examination. However, several examiners and managers expressed concerns about specializing in the consumer area because consumer law examinations were viewed as more boring than safety and soundness examinations and examiners expressed concerns about limited career opportunities in the consumer law compliance area. Some managers told us they preferred the generalist approach because it provided greater staffing flexibility.

The banking agencies in 1979 were generally not successful in staffing permanent career consumer law examiner positions. Only FRS made substantial progress and this was accomplished primarily through new hires. Commercial examiners have not opted for career consumer law compliance specialization because of their concerns about lack of challenge and limited career advancement potential. However, the agencies are working to overcome this latter concern. For example, the FDIC cites the appointment, in 1980, of three Assistant Regional Directors with consumer compliance backgrounds. Advancement opportunities such as these should facilitate attracting commercial examiners to consumer law compliance.

By 1981, the FDIC, FRS and NCUA plan to have a full staff of specialized consumer law examiners to carry out consumer law compliance examinations. This initiative should lead the way for a more experienced, committed examination staff that can tackle the substantive issues of compliance. The OCC, as part of an evaluation of its consumer examination program, is still considering various staffing options. They plan to have a cadre of specialists at a minimum.

## Training inadequate to teach needed skills

Inadequate training of examiners has also contributed to the agencies' inconsistent and inadequate examination of consumer law compliance. The amount of training provided examiners has varied by agency and region. In most cases, training was directed more to an understanding of the laws than to the specific examination techniques necessary to discover violations of the laws. Also, some concepts that were provided to examiners in training were not practicable or were not being practiced in the actual examination process.

Recently established consolidated consumer law compliance examination training provides the framework for providing consistent quality training. However, if this training is to be effective, it will have to emphasize examination techniques and their application to the principles of the laws.

Through 1979 the agencies trained examiners through formal classroom training programs, on-the-job training, and periodic informal regional conferences. The agencies' formal training, normally initiating an examiner to consumer law examination, varied from 12 hours for NCUA, 24 hours for FHLBS, 72 hours for FDIC, 80 hours for OCC, to 96 hours for FRS examiners. Formal training was structured to teach examiners the various consumer laws and key provisions of the laws. A week or more on-the-job training followed formal training and gave examiners the opportunity to perform one or more examinations with the assistance of an examiner experienced in consumer law examination. Periodically, the agencies' regions held informal conferences updating and reinforcing consumer principles. The number of these conferences and subjects discussed varied by region.

We found that most of the training focused on the requirements of the laws and gave less attention to the techniques necessary to examine for compliance with these requirements. For all the agencies, except FRS which is now hiring new consumer law examiners, there was a general assumption that examiners knew how to examine and that they only needed to know requirements for compliance. One principal exception was calculating annual percentage rates to test compliance with TIL. The three banking agencies spent considerable time teaching examiners how to verify annual percentage rate calculations. This was not performed to the same degree by the other two agencies.

Some agencies' managers recommended unique actions not normally employed in commercial examinations, such as anonymously calling the bank under examination to test for prescreening and correct quotation of annual percentage rates, discreetly overhearing institutions' receptionists and loan officers to detect prescreening and discrimination, and meeting with community groups and customers to assess compliance with CRA. One agency manager told us they were continually trying to develop new techniques that examiners could use in their examinations, particularly to identify discriminatory practices. Many examiners we talked with believed these type of concepts to be unworkable within the time frames allowed for examination, and some examiners expressed opinions that certain of these techniques were "cheap shots" and they would feel uncomfortable citing an institution based on such evidence.

Most examiners we interviewed expressed opinions that the consumer law examination training was inadequate to provide sufficient knowledge of regulations and techniques for examining compliance. Examiners cited a need for more in-depth training, greater emphasis on specific examination techniques, and more case studies included in the training programs. At least one examiner expressed a lack of confidence in his ability to examine for discrimination and said he just did not try most of the time. During our observation of six ongoing examinations, we observed:

--One examiner who did not know how to correctly calculate the annual percentage rate.

--One examiner who overlooked a TIL violation that was cited on the previous examination.

--One examiner who did not know how to use geocoding to assess CRA.

In all three instances, we brought the errors to the attention of the examiners and appropriate corrective action was taken.

### Examination procedures allow too much judgment and are insufficient to address substantive issues of consumer law

Most of the agencies' examination procedures are not sufficiently specific or detailed to ensure consistent, adequate examination of compliance with substantive principles of consumer laws. The procedures in some instances direct the use of judgment by inexperienced, inadequately trained examiners and do not require specific analyses to be performed. FRS' new examination procedures include many of the specific requirements we believe are desirable, but the examiners are not using the model workpapers in their examinations. The agencies have uniformly developed seemingly sound procedures for evaluating CRA, but the examiners are not always using them.

Depending on the nature of the law and its provisions, evaluation of institutions' compliance with the various consumer laws requires the use of different techniques. For example, determining if required TIL disclosures were made on a credit contract requires only a visual review of a selected number of loan files--no analysis is required. Similarly, determining if an institution has written and maintains a community reinvestment act statement delineating its lending area and types of credit it is prepared to extend requires only obtaining and reading the statement. Determining if an institution discriminates on a prohibited basis or if the institution is serving its community requires more than a quick reading and is often difficult to assess.

Agencies' procedures, which in some cases are quite extensive, are generally not adequate for assessing the more complex substantive issues of consumer law. In most cases, the procedures do not describe and require structured comparison and analysis of accepted versus rejected loans, analysis of monitoring information required for real estate-related loans, comparison of accepted and rejected loans to stated lending policies, and comparing HMDA data to an institutions' delineated lending area (geocoding). Without specific written procedures describing and requiring these analyses, most examiners because of inexperience and lack of techniques training did not perform analyses.

FDIC, FHLBS, and NCUA did not have procedures requiring that work be fully documented. While the agencies argue that documentation is not needed, it serves to support the fact that the examination procedures were followed and provides a basis for reviewing the work to identify discrepancies, establish trends, and evaluate the quality of examination. Without appropriate documentation and review, there is no reasonable way to determine this. We found that the agencies' staff generally did not review examination workpapers to assure consistent, quality examinations.

FRS, for most provisions of the laws, has recently established specific examination procedures, including forms for analyses, to assess the substantive issues examined. However, we found the examiners were often not following these procedures because no one was requiring it. In one FRS office we were told by a review examiner that the examiners were not required to use the agencies' model workpapers because the examiners were not adequately trained and did not know how to use the workpapers. Another FRS examiner told us the examiners experimented with different forms and procedures because they did not like the headquarters-developed forms.

The substantive provisions that we believe need more attention and specific examination procedures are not easy to assess. Using all the documents and tools that are available requires time and even then cannot assure a clear-cut conclusion. Also, there are limitations on what analyses can be done. For example, monitoring information is obtained only for real estate-related loans; similar data for other types of loans is not available. Also, prescreening, or turning an applicant away before filing an application, is difficult to determine. FDIC's inquiry log requiring the recording of all written and in person inquiries for loans is helpful for identifying prescreening. OCC is in the process of implementing a system to provide centralized analyses and monitoring of institutions' lending actions.

The agencies may have to rely on educated consumers to discern the more sophisticated forms of discrimination. However, the consistent use of specific procedures may provide indications for more indepth investigation or close monitoring. It will also serve notice to the financial institutions that their policies on discrimination/nondiscrimination are being evaluated.

## Recent OCC initiative

While all of the agencies are working to improve their examination programs, perhaps the most significant recent initiative is that of the OCC. In July 1980, the OCC created a task force on consumer examination. The task force includes representatives from OCC's policy group, regional offices, and headquarters departments. The mandate of the task force is to consider all aspects of consumer examination with a goal of conserving examiner resources and strengthening the examination and enforcement process to deal with significant, substantive consumer violations. Specifically, the task force will "identify options and make recommendations on the major issues under consideration in the review, including:

--How to refocus and streamline consumer examination procedures to strengthen substantively important areas and save time on lower priority matters

--How to structure the relative roles and responsibilities of the consumer and commercial examiners, including the commercial examiner-in-charge, in concurrent examinations

--How to allocate examiner resources more efficiently based on the size of the bank and the severity of its consumer violations

--How to restructure the examination report to emphasize important matters and deemphasize less significant items

--How to design a numerical rating system of the consumer examination

--How to improve monitoring of consumer examination quality and efficiency

--How to strengthen the enforcement process with respect to consumer laws

--How to establish examiner training programs which will provide all examiners with a working knowledge of the consumer area and provide advanced training for consumer specialists

--How to structure the commissioning process and the career path to assure general competence by all examiners in the consumer area and to create a cadre of experts to handle large banks and problem situations

--Other proposals for making the consumer examination more effective and efficient."

## CONCLUSIONS

As supervisors of the nation's financial institutions, the Federal regulatory agencies have an important responsibility for assuring not only the safety and soundness of the U.S. financial system but also the uniform protection of consumers seeking credit. If the Federal agencies are to be effective in enforcing compliance with consumer laws, then they must be effective in identifying institutional noncompliance. Also, since the laws apply equally to all financial institutions and consumers, the agencies' treatment of institutions and protection afforded consumers should be uniformly effective.

We commend the agencies for their initiative in regularly examining financial institutions' compliance with consumer credit protection laws. We also appreciate the fact that the agencies' managers, in the last few years, have worked hard to improve the agencies' compliance examination programs. These initiatives, particularly those of the last 2 years, pave the way for significant improvements in examining compliance with consumer laws. However, in our opinion, the financial institution regulatory agencies cannot achieve an adequate level of supervision until they work cooperatively to establish a uniform examination program that emphasizes both the technical and substantive requirements of the laws.

Inconsistency is unfair to consumers and financial institutions. It is unfair to consumers because they are not assured consistent protection of their rights when dealing with different financial institutions. It is unfair to financial institutions because (1) they may not be aware they are violating credit protection laws which could make them liable to civil legal actions by customers and (2) some institutions that are cited for violations feel they have to operate within more rigid guidelines than their competitors.

Agencies' examination inadequacies, particularly for discriminatory lending practices, prevent the agencies from identifying violations to assure consumers that they will be treated in accordance with the law when seeking credit at a financial institution. This defeats the purpose of the laws and prevents certain consumers from fairly attaining certain items which in our society are dependent upon access to credit.

To overcome the inconsistencies and inadequacies that exist, we believe agencies' representatives need to work together through the Federal Financial Institutions Examination Council to establish requirements for a uniform, effective examination program and commit the necessary resources to carry out the program. In our opinion, it will require developing a standard examination program including specific procedures necessary to validate an institution's compliance with the various laws. Procedures should focus on techniques necessary to answer the question of whether the institutions are complying with the substance of the law as well as the technical requirements. Technical deficiencies should not be overlooked, but examination priorities should be based on the consequences of the deficiencies, balancing the institutions' responsibilities and possible liabilities with the protection of consumers.

It will also require assigning staff in a manner that will assure a quality examination. We think it makes sense to assign full-time consumer law compliance examiners because it fosters expertise and a stronger commitment to the consumer compliance area. Recognizing some examiners' feelings and concerns about consumer law compliance examinations, an extended rotation of 18 to 24 months may be more desirable than a career commitment. But we believe each agency should have at least a cadre of career examiners to assure continuity and quality.

Committing needed resources to consumer law examination, within existing staffing structures may necessitate decreasing the frequency of examination. Because consumer law compliance is different than safety and soundness, less frequent examination may be acceptable. One quality examination less frequently, with appropriate followup on action taken to correct violations, could accomplish more than a less indepth review every 12 or 18 months. Consumer complaints could be relied on to surface interim compliance problems.

To assure quality examination, examiners will have to be better trained in the techniques for examining substantive matters. Knowledge of the laws is certainly an important prerequisite, but specific techniques of examination are needed to assure consistency and to maximize results in minimum time. The agencies are taking the first step to assure consistency by setting up a uniform consumer law compliance training program.

OCC's newly established consumer examination task force seems to be a rational, comprehensive approach to enhancing the consumer examination process. In light of our recommendations below, we believe this to be a timely action which all of the agencies should consider undertaking. The inclusion on the task force of policy, regional, and divisional staff will broaden its perspective and should better facilitate workable answers.

## RECOMMENDATIONS

We recommend that the Chairmen of the Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, Federal Reserve Board, and National Credit Union Administration and the Comptroller of the Currency work together under the direction of the Federal Financial Institutions Examination Council to develop and administer a consistent, effective consumer law compliance examination program. The recently established OCC task force on consumer examination provides a timely example of how to pursue such a course. In particular, the agencies should:

--Reassess the nature and objectives of consumer law compliance examinations and define criteria for examination frequency.

--Develop uniform examination procedures and instructions for all consumer laws that detail specific worksteps to assess the substantive as well as the technical provisions of the laws and regulations.

--Determine and allocate the level of resources necessary to implement uniform examination procedures.

--Continue, or in the case of FHLBS establish, programs providing separate career paths for consumer law compliance examiners, or establish extended staff rotation programs of 18 months or more, to ensure consistent deployment of highly qualified examiners.

--Place more emphasis on examination techniques to assess the substantive requirements of the laws and regulations in the consolidated training program for consumer law compliance examiners.

Further, we recommend that the Federal Financial Institutions Examination Council monitor the progress of the OCC task force on consumer examination to determine the applicability and value of such a review for the other financial institution regulatory agencies.

## AGENCY COMMENTS

The agencies generally agreed with our recommendations for improved examinations. However, most of the agencies did not believe their programs were inadequate for assessing certain aspects of compliance. The FHLBS, contrary to the findings of GAO and the experience of the other four agencies, disagreed with the need for specialized consumer examinations.

The agencies, individually, and collectively through the Federal Financial Institutions Examination Council cite several responsive initiatives taken since the completion of our review. For example, the FDIC and OCC have begun using computerized systems to help target institutions that may be discriminating in granting housing-related credit. The FDIC is experimenting with more structured, better documented analyses of accepted versus rejected loans and HMDA data. Also, the FDIC has issued directives to its examiners to initiate contacts with community groups and individuals in the local community where the bank is located. The NCUA, as stated earlier in the report has established a separate consumer compliance program and is developing a staff of specialized consumer compliance examiners. The FRS, which during the course of our review had begun increasing staffing dedicated to consumer compliance examination, has continued its efforts to allocate adequate resources to consumer compliance examination. Also, the FRS has developed improved training programs to assist examiners in finding hard-to-detect substantive noncompliance. The FHLBS recently acquired programmable calculators to enhance its TIL examinations.

Collectively, through the Examination Council's Task Force on Consumer Compliance, the agencies have adopted uniform CRA and Electronic Funds Transfer Act examination guidelines and are working on similar guidelines for TIL.

Also, since our review, the uniform interagency training school has begun providing training to all of the agencies' examiners. OCC and FRS training program improvements made over the last 18 months were incorporated into the interagency training program.

Although the agencies generally agreed with our recommendations and cite several actions to improve their programs, FHLBS, FRS, and OCC generally disagreed with our findings that their programs were inadequate for identifying violations of some provisions of the laws. Also, they suggested that our report could have been more useful if it compared individual agency program strengths and weaknesses. All of the agencies, contrary to our findings, state that their programs were directed at determining substantive compliance and did not emphasize or focus on technical compliance.

Our analysis showed that the examinations in each of the offices we visited were inadequate to determine compliance or noncompliance for the provisions of the ECOA and FHA laws we cite in the report at least 20 percent of the time. Our analyses for CRA, while not statistically representative, showed similar indications. In those cases that we determined the examination to be inadequate, the examiners' analyses were insufficient to demonstrate compliance or noncompliance.

We did not go into more detail on each agency's program because specific findings were discussed with officials at regional offices and at Headquarters as we concluded our work. Further, extensive detail on each agency's program detracts from the more important overall message of the report. However, to the extent that one agency's program is significantly stronger or weaker than the other agencies' programs, we point this out in the report.

While all of the agencies suggest that their examinations were directed at determining substantive compliance, the examination results we reviewed generally did not reflect this. The time spent, the level of analyses, the training and experience of examiners most often pointed to an emphasis on technical compliance.

FHLBS in its comments, argued against separate consumer compliance examinations citing start-up problems experienced by the other regulators and questioning the value of such a change. The FDIC and FRS, in their comments, made strong arguments for separate consumer compliance examinations and supported specialized consumer examiners. NCUA and OCC are supportive of separate examinations as well. FHLBS defends its position primarily on efficiency grounds--staffing and resource requirements, burden and cost to the industry. However, from an effectiveness standpoint, in terms of directing committed, expert resources to consumer compliance matters and getting the attention of institutions' management, we believe separate examinations offer the better alternative. After adequate examination procedures are developed and used for a while and institutions have become more familiar with consumer credit law requirements, it may be possible to go back to a consolidated examination without a loss of effectiveness.

Finally, OCC in its comments raised questions about the usefulness of our findings, specifically based on our observations of six onsite examinations. Because of the agencies' refusal to allow us direct audit access to financial institutions, we could not perform this review in the manner we thought most productive. However, we do believe our methodology was sound and for the regions we visited portrays an accurate picture of operations for the period we reviewed. Our findings are based principally on analyses of examination reports and supporting workpaper documents. Discussions with agency examiners and managers and the observation of six ongoing examinations were used to verify our findings. Any specific examples noted on these onsite observations were supportive of our findings.

# CHAPTER 3

# AGENCIES NEED UNIFORM COMPLIANCE ENFORCEMENT STANDARDS

The regulatory agencies request and obtain compliance from financial institutions for most violations, but the agencies' practices are inadequate for ensuring correction by institutions that do not voluntarily comply. The agencies' failure to ensure compliance with the consumer laws in these cases tends to neutralize the intended effect of the laws. The agencies do not have standard criteria to enforce compliance, and until recently the agencies have not generally emphasized enforcement. The agencies' only attempt at uniform standards was carried out inconsistently and suspended 8 months after implementation. Although the first attempt at standards failed, we believe the agencies need standard enforcement criteria supported by top management if consistent across-the-board compliance is to be realized.

## AGENCIES NOT CONSISTENTLY OR ADEQUATELY ENFORCING COMPLIANCE

Although consumer credit protection laws have been in effect for several years, most financial institutions continue to be cited for noncompliance with some portion of these laws. New laws, institutional revisions, new staff members, and improved agency examinations in part account for the continuing identification of violations. However, institutions' indifference coupled with the regulators' failure to make institutions correct violative practices contributed to the continuation of a number of violations.

Our analysis of reports and correspondence for a sample of 110 institutions showed that financial institutions voluntarily acted to correct violations brought to their attention by the Federal regulators about 77 percent of the time.

At the conclusion of a compliance examination, examiners write a report of examination summarizing violations noted, and the agencies' regional offices usually send a letter to the financial institution requesting that the institution correct violative practices.

For the 110 institutions in our sample, of 604 total violations in the second most recent report of examination, 468 or 77 percent were not reported as continuing violations in the most recent examination report. However, 23 percent of the violations cited in the second most recent report were cited again in the most recent examination report. Fifty-two of the 110 institutions in our sample, or about half of the institutions, continued to violate at least one of the laws and a few institutions continued the same violation through three consecutive examinations.

Many of the repeat violations were recurring omissions of technical details. However, about 35 percent (48) of the 136 repeat violations were more serious. From one examination to the next, for example, institutions were cited for

--prescreening applicants,

--obtaining and maintaining prohibited information,

--requiring cosignatures, and

--incorrectly calculating annual percentage rates.

The last three types of violations accounted for most of the more serious violations.

While the agencies, through examination and requests for corrective action, have obtained correction of a number of violations, their techniques are not effective when the bank does not voluntarily comply. For example, one institution in our sample can serve to illustrate the magnitude of repeat violations. In 1977, the consumer examination of the institution cited 11 violations. A year later, examiners noted 10 violations, including 4 repeat violations--2 of TIL, 1 of ECOA and 1 of the Real Estate Settlement Procedures Act. In the third examination, 20 violations were cited, including 5 repeat violations. One was repeated only from the 1978 examination--for Fair Credit Reporting, but four of the violations were repeated from both the 1977 and 1978 examinations--2 of TIL, 1 of ECOA and 1 of the Real Estate Settlement Procedures Act. Following the first two examinations, the agency sent letters to the institution requesting corrective action be taken, which the institution promised. Following the most recent examination, the agency required the institution to respond with a letter within 30 days describing the measures taken to eliminate the violations and submitting copies of corrected forms. Although the repeat violations for this particular institution were generally technical, the number of violations and the continuation of violations suggest that the agency should have done more to either assist or monitor the institution's corrective action.

Another example is an institution that was cited for 13 violations of various consumer compliance laws in an examination performed in November 1977. Some of the violations had substantive implications, for example:

- --Failure to provide rejected applicants a reason for denial.
- --Failure to maintain records on rejected loans.
- --Failure to obtain equal credit monitoring information.
- --Failure to provide TIL disclosures for all loans.

As is usually the case, the agency wrote the institution a letter requesting corrective actions be taken and the institution agreed to take such actions. Eighteen months later, the agency examined the institution and identified 13 violations, including 10 repeat violations. The institution has now been identified for closer supervision and follow up examination; however, for 18 months the institution continued uncorrected a number of practices identified as violating consumer laws.

## Enforcement is inadequate and inconsistent

The agencies can employ a number of different enforcement techniques to assure institutions' compliance including

- --moral suasion, generally in the form of a request for a statement describing the institution's efforts to effect compliance;
- --meetings with the institution's Board of Directors;
- --followup supervisory visits;
- --interim examinations;
- --letters of agreement; and
- --cease and desist orders.

However, we found the agencies, regardless of the significance or persistence of the violation, relied primarily on moral suasion, the weakest of the enforcement tools, and accepted compliance to the extent the institutions voluntarily responded to this technique.

For our sample of institutions, excluding NCUA, we found in about 90 percent of the cases, the agencies sent letters to institutions identifying the violation and requesting advice on measures taken or planned to take to correct violations. In 16 percent of the cases, the institution was requested to return copies of actual blank forms or other evidence that a change was made. The agencies performed followup supervisory visits for about 4 percent of the cases in our sample and met with the institution's Board of Directors in one instance.

We identified one case where although only a very few violations were identified in the most recent examination, no enforcement action was taken, not even a citation in the report of examination, because regional management considered the institution "clean." While this was not an FDIC-supervised bank, the FDIC suggests that this might be an acceptable practice depending on the circumstances. We believe this type of discretion does not foster an effective continuing supervisory process.

When an institution continued to violate a law from one examination to the next, we found, in almost all cases, the agencies continued to rely on moral suasion to correct the problem. In only about half of the the cases did the agencies place greater emphasis on correcting noncompliance using a more strongly worded letter, a request for evidence of correction, or a supervisory visit. In the remainder of the cases, agencies' enforcement practices were the same as when the violations were first cited.

While it seems appropriate to differentiate between substantive and technical noncompliance, for the period of our review only the FRS made such a distinction and none of the agencies delineated between substantive and technical violations for enforcement purposes. The agencies' enforcement action for a substantive violation such as prescreening was no different than enforcement action for a technical violation such as not posting the fair housing poster. In 1979, OCC was drafting guidelines to classify violations as either substantive or technical for enforcement purposes. Subsequently, the FRS discontinued its efforts to distinguish between substantive and technical because of difficulties in classifying certain violations.

Some, but not all, of the agencies identify and maintain lists of compliance problem institutions for monitoring purposes. The FRS, at headquarters, had a list of problem compliance situations, but the list had not been shared with the regions we visited and had not been used to enforce compliance. FDIC has had a problem list for a number of years, but at the time of our review it was not current and was not being used for monitoring purposes. FHLBS also has a system to monitor problem nondiscriminatory situations. However, this is managed at the Headquarters and we found no awareness of such a system in the field offices.

The three agencies, in varying degrees, disagree with our observations on their systems for monitoring problem institutions. However, when we asked for a selection of problem institutions for our evaluations, each of the offices we visited could not readily produce such a list.

To evaluate the agencies' actions for difficult noncompliance institutions, therefore, we asked each regional office to identify their worst compliance institutions. Our analysis of examination reports and correspondence for 36 identified institutions showed the agencies' actions to be inconsistent and generally ineffective for achieving change.

Although there was no specific criteria establishing those 36 cases as worst cases, generally the examination reports for these institutions showed greater numbers of total and repeat violations. For example, 1 institution for 1977, 1978, and 1979 had 25, 20 and 31 violations, respectively, including 10 violations--4 for ECOA, 4 for TIL, 1 for Fair Credit Reporting, and 1 for flood insurance--that continued through all 3 examinations. Another institution identified as a worst compliance situation for examination in 1977, 1978 and 1979 showed violations of 18, 19, and 42 in each respective year including 5 violations continuing through all examinations. Also, for the worst cases, citations of possible discriminatory practices were reported more frequently.

Agency interaction with these worst compliance institutions was generally more intense each year including more followup and interim visits, but only one-third of these institutions reduced the number of consumer violations over the 2 to 3 year period considered. No cease and desist orders had been issued for the 36 institutions.

The agencies differed on their supervision of these worst cases. FDIC followed up on the examination with onsite examiner compliance visits, and in a few cases, meetings with Boards of Directors. FRS relied heavily on followup correspondence and meetings with Boards of Directors. In two instances, the FRB-Richmond required the non-complying bank to internally audit portions of its compliance procedures. OCC used stronger transmittal letters and in a few instances, compliance visits.

For the cases where the violations remained uncorrected, we question whether action taken by the agency was commensurate with the severity or persistence of the situation.

## Cease and desist orders seldom used to enforce compliance

The agencies have not often used their authority to initiate cease and desist orders to force compliance with the consumer laws. Cease and desist orders initiated by the agencies specifically for failure to comply with consumer laws total 18--13 by FDIC, 3 by OCC, and 2 by FRS. In contrast, in the last 3 years, these 3 agencies initiated more than 200 cease and desist orders to correct safety and soundness deficiencies including 120 by FDIC, 60 by OCC, and 36 by FRS.

FHLBS and NCUA have not initiated any cease and desist orders specifically for consumer noncompliance, but rather in conjunction with cease and desist orders issued for safety and soundness deficiencies. In 1979, NCUA began processing two cease and desist orders specifically for consumer compliance, but corrective action was taken by the institutions before the proceedings were finalized.

We were told by one regional consumer official that the use of formal enforcement action such as cease and desist orders was dependent on factors such as the institution's financial condition. For example, when an institution is experiencing consumer problems, it may be experiencing financial difficulties as well and the agencies prefer to first resolve safety and soundness deficiencies. Also, we were told the agencies hesitate to resort to a cease and desist order for a continuing violation that is perceived as having no material effect on consumers, for example, failure to post the fair housing poster in the lobby of the bank.

## CONSUMERS' RIGHTS NOT PROTECTED

The agencies' failure to enforce institutions' compliance with consumer laws tends to neutralize the intended effect of the laws, including protection of consumers seeking credit. While the institutions have primary responsibility to comply with the laws, the agencies' reluctance to employ stronger enforcement methods when institutions do not comply allows institutions to continue to violate the laws. Because some institutions do not fully comply with the laws, some consumers are not receiving accurate disclosures of their finance charges, annual percentage rates and their right to rescind certain transactions. Further, consumers may be denied credit based on prohibited information and without an appropriate statement of why credit was denied.

Agencies' enforcement actions preclude consistent protection for consumers. Whenever an institution is allowed to continue violative practices, of which about one-third of the repeat cases in our sample were substantive or had substantive implications, consumers' rights in seeking and obtaining credit are denied. Consumers who agree to credit based on understated finance charges or annual percentage rates may unknowingly be losing money. Consumers who have to provide prohibited information to obtain credit may be unfairly denied credit or the right to obtain credit based on their financial merit.

Differences in agencies' commitment to enforcing consumer laws result in unequal treatment of financial institutions. These disparities serve only to accentuate the differences described in the previous chapter on examination. Just as the rigor of agencies' consumer examinations differ, so does subsequent enforcement. Individual financial institutions forced to compete for the same dollars and customers in basically similar markets must operate under supervisory burdens unequal to that of competitors. Also, the FDIC with its more aggressive use of cease and desist orders was forcing corrective actions through legal proceedings.

Financial institutions generally complying with the laws are examined, a form of regulatory burden, as often as their counterparts that do not comply.

## ENFORCEMENT WEAKNESSES STEM FROM A LACK OF STANDARDS AND EMPHASIS

A lack of standard compliance enforcement criteria and a general lack of emphasis on enforcement by the agencies have contributed most to the agencies' inconsistent and ineffective enforcement. Neither the laws nor the regulations specify the nature of enforcement that is to be applied for a given circumstance of noncompliance. Most of the laws state that the regulators can use their full range of enforcement authority, including formal administrative action such as a legally binding cease and desist order. The agencies, because of the controversies concerning the laws and the complexities of some of the laws, have not emphasized the strong enforcement of consumer compliance. In the last year, the agencies have individually issued new directives to emphasize more standardized enforcement of noncompliance, but these were not evident during the period of our review and we do not know how the guidelines will work in practice.

The laws and implementing regulations do not provide for specific penalties for specific acts or patterns of noncompliance. The agencies until recently had not developed formal or informal guidelines to direct examiners and regional managers whose background generally emphasizes safety and soundness. While the agencies' overall approach to enforcement has been a conservative advisory-type one, the aggressiveness of regional enforcement has depended largely on the individual personalities of regional managers. Some formal actions to force compliance have been initiated, primarily by FDIC offices; but in the absence of specific guidance, the approach followed has generally been continued requests for voluntary compliance.

The regional managers' actions are a reflection of the limited direction they have received from agencies' headquarters. Agencies' management had not issued directives emphasizing strong enforcement and regional managers have acted similarly.

For many of the same reasons for inadequate examinations described in chapter 2, the agencies have not emphasized enforcement of consumer laws. The agencies have operated under the belief that the majority of violations are technical violations which should be corrected but do not warrant formal enforcement measures. The agencies until 1978 were not accumulating data in a form that would allow them to support or dispel this notion. Since accumulating this data, their statistics indicate a majority of the violations are technical. However, agencies' statistics show that more than 10 percent of the violations noted are of a substantive nature. Further, our sample showed that about 35 percent of the repeating violations were substantive violations or had substantive implications.

The agencies' first attempt at implementing uniform enforcement guidelines--for TIL--was not successful. The agencies implemented the guidelines inconsistently and, because of various technical problems finally suspended implementation. The uniform guidelines were a significant step forward in that they required corrective action commensurate with the violation. Acts which financially affected consumers required reimbursement to consumers. Other violations were reported to the institution for correction, but no price tags were associated with them.

During the 9-month period when the uniform guidelines were in effect, the agencies identified about $1.5 million in reimbursable TIL violations, mostly identified by OCC and FRS. The agencies estimated an additional $5 to $10 million in reimbursable TIL violations for the industry. Of the totals identified, about $750,000 was actually reimbursed to customers.

None of the agencies at the time of our review had developed a planned comprehensive approach for enforcing and maintaining compliance with consumer laws. Compliance activities were not unified or coordinated to achieve maximum results and compliance strategy was devised on an ad hoc basis, tailored, according to the agencies' regional officials, to the needs of individual institutions.

The agencies' approaches were fragmented, sporadic, and tended to overlook appropriate considerations. For example, in our opinion, an effective enforcement program should consider prior examination results to both monitor agencies' progress and to emphasize repeat violations. While the agencies normally considered prior examination results in their most recent examinations, our review of reports, workpapers and correspondence in one region revealed that 20-25 percent of recurring violations were not specifically identified as such in either the examination report or accompanying transmittal letter to the institution. Though we are unable to extrapolate these findings, they indicated potential deficiencies in agencies' efforts to followup and emphasize continuing noncompliance.

Rating and monitoring systems prominent in the supervision of safety and soundness have received only limited use in the consumer area. FRS and FDIC have established formal rating systems that succinctly identify the status of institutions' compliance with consumer laws. FHLBS and NCUA have assigned overall ratings for combined commercial and consumer areas. NCUA separately rated consumer compliance, but the overall institution rating was the rating used for supervisory purposes. A recent organizational change at NCUA separates the commercial and consumer areas, providing for separate examinations and ratings.

Prioritizing and scheduling consumer examinations often have been determined by factors unrelated to the achievement of consumer compliance. For example, FDIC generally examines the institutions it supervises once every 18 months based on an internally established examination requirement. OCC conducts separate consumer and commercial examinations, but they may perform both simultaneously. In one OCC region we reviewed, national banks were examined for consumer laws according to commercial examination frequency criteria, including bank size and commercial rating. In another region, OCC gave separate consideration to the level of compliance with consumer laws and examinations were not conducted simultaneously with commercial examinations. FHLBS and NCUA consumer examinations have been a segment of the commercial examination and performed in accordance with commercial frequency requirements. FRS policies have directed consideration of a bank's performance when scheduling consumer examinations, but inadequate staffing has precluded following this policy in some cases.

### Recent initiatives

All of the agencies have recently initiated changes in their programs to enhance enforcement. The agencies, under the direction of the Federal Financial Institutions Examination Council, uniformly adopted new TIL enforcement guidelines. Individually the agencies have issued enforcement guidance to their field offices directing a stronger, more consistent approach to enforcement. These actions are recent, however, and were not in place during our evaluations of the agencies' practices at the regional level, thus precluding our assessment of their value in practice.

## CONCLUSIONS

Agencies' enforcement of consumer laws, for the institutions in our sample, was effective when institutions voluntarily complied with recommended changes. When moral suasion was not effective, the agencies did not generally use stronger enforcement measures and were not effective in achieving compliance.

Consequently, some consumers did not always receive the protection afforded by the laws, and those institutions that complied with the laws were treated no better than those that did not comply. Some consumers when dealing with some institutions, because the laws were not enforced, were no better off than before the laws were written. They still did not receive a meaningful disclosure of credit terms and they may have been discriminated against.

Financial institutions that have tried to comply with the laws are burdened with the same regulatory review as noncomplying institutions adhere to the laws. Also, some institutions were treated more or less severely depending on the regulatory agency.

The agencies' regional managers who have front line responsibility for supervising compliance had no standards for initiating enforcement actions and received no encouragement from the agencies' top management to emphasize enforcement. Factors such as the institution's financial condition entered into the decision-making process resulting in inconsistent enforcement.

The agencies' initiatives to implement enforcement standards are a positive step to strengthening enforcement.

To assure consistent enforcement for all financial institutions, however, the agencies should work to establish uniform enforcement standards which they all would use.

## RECOMMENDATIONS

We recommend that the Chairmen of the Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, Federal Reserve Board, and National Credit Union Administration, and the Comptroller of the Currency under the direction of the Federal Financial Institutions Examination Council establish and, to the maximum extent practicable, use uniform enforcement standards to correct violations of consumer laws. Such standards should recognize variations in significance of violations and the persistence of violations. The standards should also include probable penalties that will be invoked for noncompliance.

We further recommend that each of the agencies provide such standards to the institutions they supervise.

## AGENCY COMMENTS

The agencies generally agreed with our recommendation to establish and use uniform enforcement standards. Recent enactment of uniform TIL enforcement standards and initiatives to establish uniform ECOA enforcement standards reflect the agencies' efforts to meet this commitment. Similarly, FDIC and OCC directives in the last year provide examiners and regional managers a better framework for taking enforcement actions. Only the FHLBS expressed concerns about subordinating its enforcement prerogatives to the consensus of the Federal Financial Institutions Examination Council.

We support formalized standards because they provide the regulators, the institutions, and interested consumers a standard benchmark for enforcement. While inclusion of such standards in regulations may be impracticable, publication of such standards in some form is desirable. We believe it appropriate that the Examination Council, as the coordinating mechanism for the agencies, serve as the focal point for establishing such uniform standards.

The FDIC and OCC question our use of the term "repeat violation." We use "repeat violation" to mean the continuation of a practice cited in a previous examination as violating the law. While the agencies' examination reports and workpapers were not always complete, we were normally able to determine that the examiner was citing the institution for the same practice cited in the previous examination.

The FDIC comments that our assessments of unequal treatment of financial institutions is overstated. However, our analyses showed that the agencies, including FDIC, did not generally make quality distinctions among institutions when establishing examinations. In some cases, particularly for FDIC, followup visitations were made. However, our review did not show that these visitations were initiated in accordance with any established standard criteria. The OCC also questioned our characterization of unequal treatment, asserting that most national banks were in substantial noncompliance for the period of our review and warranted equal visitation. Our review of reports and workpapers did not generally support this assertion.

FDIC and OCC identified new initiatives to support managers in enforcing compliance. These include standards, directives to field managers, and for OCC, special seminars for its regional managers in early 1980 to emphasize consumer compliance enforcement. We believe these are the type of measures needed to support regional managers.

## Major Consumer Credit Protection Legislation 1968 - 1979

| | Act | Emphasis | Year Enacted |
|---|---|---|---|
| 1. | Truth in Lending Act(15 U.S.C.§§ 1601 *et seq.*) | Provides meaningful disclosure of terms and conditions in consumer credit transactions and offers to extend credit. | 1968 |
| 2. | Fair Housing Act (Title VIII of the Civil Rights Act of 1968)(42 U.S.C. §§3601 *et seq.*) | Creates equal housing opportunity for all, eliminates discriminatory patterns and practices in any aspect of housing. | 1968 |
| 3. | Fair Credit Reporting Act (15 U.S.C. §§ 1681 *et seq.*) | Provides for fair and equitable reporting of credit information with regard to confidentiality, accuracy, relevancy, and use of such information. | 1970 |
| 4. | Flood Disaster Protection Act (42 U.S.C. § 4002) | Requires Federally supervised lending institutions to require flood insurance under the National Flood Disaster Act for property in a designated flood zone. | 1973 |
| 5. | Real Estate Settlement Procedures Act(12 U.S.C. §§2601 *et seq.*) | Provides more effective disclosure of settlement costs to home buyers and sellers; eliminates kickbacks or referral fees, and reduces escrow account requirements. | 1974 |
| 6. | Equal Credit Opportunity Act(15 U.S.C. §§1691 *et seq.*) | Prohibits discrimination with respect to any credit transaction on the basis of race, sex, marital status, color, religion, national origin, or age. | 1975 |

| | Act | Emphasis | Year Enacted |
|---|---|---|---|
| 7. | Fair Credit Billing Act (15 U.S.C. §§ 1665a *et seq.*) | Establishes billing disclosure requirements and consumer rights in resolving billing discrepancies. | 1975 |
| 8. | Home Mortgage Disclosure Act (12 U.S.C. §§ 2601 *et seq.*) | Provides citizens and public officials information to assess whether depository institutions are meeting obligations to serve housing needs of communities in which the institutions are located. | 1975 |
| 9. | Consumer Leasing Act(15 U.S.C. §1667) | Provides meaningful disclosure of the terms of personal property leases for personal, family, or household purposes. | 1976 |
| 10. | Fair Debt Collection Practices Act (15 U.S.C. § 1601) | Eliminates abusive debt collection practices by debt collectors. | 1977 |
| 11. | Community Reinvestment Act (12 U.S.C. § 1815) | Encourages regulated financial institutions to help meet the credit needs of their local community. | 1977 |
| 12. | Right to Financial Privacy Act (12 U.S.C. § 3401) | Limits government access to information contained in an individual's financial record. | 1978 |
| 13. | Electronic Fund Transfer Act (Pub. L. No. 95-630, title XX) | Protects consumer rights and safeguards in electronic transfer systems and provides a framework for defining the liabilities and responsibilities of all participants in electronic fund transfers. | 1978 |

In addition, there are other laws which govern consumer credit activities. TIL provides basic requirements for advertising credit terms. The Federal Trade Commission Act requires the Federal Trade Commission and the FDIC, FRS and OCC to handle consumer complaints. The Federal Trade Commission Preservation of Consumers' Claims and Defenses Trade Rule (1975) requires a seller to fulfill obligations under an agreement even if the loan is sold to a third party.

## FEDERAL AGENCIES AND THEIR CONSUMER COMPLIANCE ENFORCEMENT RESPONSIBILITIES

| | TRUTH IN LENDING | FAIR CREDIT BILLING | CONSUMER LEASING | FAIR CREDIT REPORTING | EQUAL CREDIT OPPORTUNITY | FAIR DEBT COLLECTION | ELECTRONIC FUND TRANSFERS | FAIR HOUSING * | FLOOD DISASTER PROTECTION | HOME MORTAGAGE DISCLOSURE | REAL ESTATE SETTLEMENT PROC. | RIGHT TO FINANCIAL PRIVACY | COMMUNITY REINVESTMENT ACT | GARNISHMENT RESTRICTIONS |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Federal Deposit Insurance Corporation | X | X | X | X | X | X | X | X | X$^{A}$ | X | X$^{B}$ | X | X | |
| The Office of the Comptroller of the Currency | X | X | X | X | X | X | X | X | X$^{A}$ | X | X$^{B}$ | X | X | |
| Federal Reserve System | X | X | X | X | X | X | X | X | X$^{A}$ | X | X$^{B}$ | X | X | |
| Federal Home Loan Bank System | X | X | X | X | X | X | X | X | X$^{A}$ | X | X$^{B}$ | X | X | |
| National Credit Union Administration | X | X | X | X | X | X | X | X | X$^{A}$ | X | X$^{B}$ | X | | |
| Farm Credit Administration | X | X | X | | X | | | X | X$^{A}$ | | X$^{B}$ | | | |
| Federal Trade Commission | X | X | X | X | X | X | X | X | X$^{A}$ | | | | | |
| Civil Aeronautics Board | X | X | X | X | X | X | X | | | | | | | |
| Secretary of Agriculture | X | X | X | X | X | X | | | | | | | | |
| Interstate Commerce Commission | | | | X | X | X | | | | | | | | |
| Security and Exchange Commission | | | | | X | | X | | | | | X | | |
| Small Business Administration | | | | | X | | | | | | | | | |
| Department of Housing and Urban Development | | | | | | | | X | X | | X | | | |
| Department of the Treasury | | | | | | | | | | | | X | | |
| Department of Justice | | | | | | | | X | | | | | | |
| Department of Labor | | | | | | | | | | | | | | X |

* Fair Housing Act cites only HUD as administrator; cites other affected executive departments and agencies but does not include names of specific agencies; Department of Justice is given authority to bring suits.

A-By inference of the law.

B-By inference of Regulation X (Real Estate Settlement Procedures)

Federal Financial Institutions **Examination Council**, Washington, D.C. 20219

October 30, 1980

Mr. William J. Anderson, Director
General Government Division
United States General Accounting
   Office
Washington, D.C.   20548

Dear Mr. Anderson:

The GAO's draft report entitled, "Financial Institution Regulators Need to Focus on Substantive Principles of Consumer Legislation During Compliance Examinations" contains two comprehensive recommendations for action by the Federal Financial Institutions Examination Council. The Council's comments on the draft report relate primarily to these recommendations and do not address the overall content of the report.

In regard to the first recommendation that the agencies develop consistent, effective consumer law compliance examination programs that adequately stress the substantive principles of the laws, the Council has since its organization in 1979 promoted uniformity in the consumer compliance examination programs of the agencies. The Council's Task Force on Consumer Compliance has worked diligently towards this objective, and admittedly still has much to do. Task Force efforts initially were concentrated in areas where new statutory responsibilities had been mandated or new agency policy positions were being developed. Achieving agency agreement in new areas was far less difficult and provided a base from which further uniformity could be achieved. Examples of Task Force achievements made in areas of new statutory responsibility was the development and implementation of Community Reinvestment Act, Electronic Fund Transfer Act, and Right to Financial Privacy Act uniform examination procedures, as well as uniform Truth in Lending restitution policy positions. Task Force efforts in these areas have adequately stressed both the basic principles of the statutes, as well as the technical provisions of the laws.

Toward its goal of uniformity, the Council's Task Force has completed studies of the similarities and differences in agency examination procedures for both the Truth in Lending Act and the Equal Credit Opportunity Act. The Task Force routinely researches and solves problems common to the agencies' compliance programs in an effort to promote uniformity. In addition, the Task Force is participating in the development of the Council sponsored consumer compliance school.

Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board,
National Credit Union Administration, Office of the Comptroller of the Currency

Mr. Anderson

The Task Force in its efforts since 1979 has attempted to develop examination procedures and enforcement standards which would ultimately result in correction and detection of noncompliance at all federally supervised financial institutions. The report states that agency approaches to detection of noncompliance preclude detection of substantive violations of the Equal Credit Opportunity Act, the Fair Housing Act and the Community Reinvestment Act. Agency programs for detection of discrimination and fulfillment of community credit needs are relatively new. The Task Force will be reviewing agency experience with these programs in the future, making suggestions for improvement where necessary.

The GAO draft report also recommends that the agencies under the direction of the Council implement uniform enforcement standards for violations of consumer laws. The Council's Task Force on Consumer Compliance has developed a uniform Truth in Lending Act enforcement policy which has been implemented by the agencies. Additionally, the Task Force is developing a uniform enforcement policy to be used by the agencies when certain violations of the Equal Credit Opportunity and Fair Housing Acts are detected.

Since the consumer protection laws are enforced by as many as 16 Federal agencies, the Council does not support the report's implication that uniform enforcement standards established by the Council will result in consumers receiving adequate protection under the consumer laws -- particularly the Equal Credit Opportunity and Truth in Lending Acts, or that financial institution managers will perceive these efforts as equalizing or easing their regulatory burdens. As stated in the report on page 3, financial institution managers complain that they are supervised more severely than competitive creditors. In fact, state chartered credit unions, nondepository credit and retail institutions, commercial retail operations and most mortgage companies, each regulated by the Federal Trade Commission, are not routinely examined for consumer law compliance. Thus, financial institutions will continue to bear an uneven regulatory burden when compared to their competitors. And similarly, only consumers that shop for credit at financial institutions will be afforded a degree of protection through uniform enforcement standards. The Council agrees, however, that it has responsibility for developing uniform enforcement procedures for consideration and posssible adoption by its member agencies.

Sincerely,

Robert J. Lawrence

Robert J. Lawrence
Executive Secretary

FEDERAL DEPOSIT INSURANCE CORPORATION Washington D C 20429

OFFICE OF THE CHAIRMAN

October 24, 1980

Mr. William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

We appreciate this opportunity to comment on the GAO draft report entitled "Financial Institution Regulators Need to Focus on Substantive Principles of Consumer Legislation During Compliance Examinations." Our comments will not address specifically the Digest (pp. i through v) but instead will focus on the body of the report. We assume that whatever changes are made in the report proper as a result of our comments will appropriately be reflected in the Digest.

The following comments are submitted with respect to the specific portions of the report indicated:

1. The second paragraph on page 6 alludes to "The agencies' emphasis on technical compliance in lieu of substantive compliance . . ."

We reject the notion that the FDIC has emphasized "technical" and, by implication peripheral matters, at the expense of "substantive" compliance. From the beginning, we have attempted to uniformly enforce the various requirements and proscriptions of the relevant statutes and regulations without distinction. In our view, if particular requirements or proscriptions are important enough to have been written into the relevant statutes or regulations, they are important enough to be enforced. We do not believe the statutes or regulations authorize us to pick and choose among the requirements or proscriptions we will enforce and neglect to enforce those we might choose to label "technical." Admittedly, some requirements or proscriptions are more important than others but in our view all must be enforced and we have not consciously or unconsciously "emphasized" technicalities. Where relatively few of certain types of violations of a more serious nature have been discovered, we believe the paucity, to the extent such violations in fact exist, is explainable more in terms of the relative ease or difficulty of finding the violations and not from any failure of emphasis.

2. The second paragraph on page 6 also alludes to the agencies' "need to establish one uniform examination program addressing the substantive principles as well as the technical requirements of the laws."

The agencies have for some time been moving in the direction of a uniform examination program and have, for example, jointly developed and adopted uniform CRA examination procedures, uniform EFT Regulation E examination procedures and are currently developing uniform Truth in Lending Regulation Z examination procedures. In addition, the agencies have recently established an interagency consumer compliance training program. We expect this process to continue under the aegis of the Federal Financial Institutions Examination Council and, more particularly, its Consumer Compliance Task Force, and that the uniform programs developed will properly address all of the requirements of the various laws and regulations for whose enforcement the agencies are charged, including especially those of a more serious nature that might be characterized as embodying or reflecting "substantive principles."

3. The third paragraph on page 6 states the GAO's conclusion that the agencies' "examinations were not adequate to assess institutional compliance with the substantive provisions of the ECOA, FHA, and CRA."

With regard to equal credit opportunity, we recognize that we have not been able to detect instances of discrimination on one or more of the prohibited bases under the ECOA and FHA to the extent they probably exist in the credit-granting process. As a result, we have moved to upgrade our efforts, particularly with respect to housing-related credit. In this regard, we have developed over some time and recently implemented a data collection and analysis system designed to suggest the presence or possibility of discrimination on a prohibited basis in this type of credit. In essence, the FDIC system, designated COMPASS for COMPuter Assisted Supervisory System, involves the collection and computer analysis of data on accepted and rejected mortgage loan applications received from women and minorities and compares similar data elements with applications received from whites. It is hoped this more sophisticated type of analysis will help identify cases that warrant closer scrutiny during compliance examinations. In addition, we are beginning to experiment with a more structured, documented approach, particularly with respect to the analyses performed, in examining for evidence of discrimination on a prohibited basis in other types of credit as well.

With regard to CRA, we believe we have been doing a credible job of assessing the records of insured nonmember banks in meeting community credit needs in view of the difficulties inherent in determining in a cost-efficient way an institution's record of meeting community credit needs. These difficulties include the problem of gauging loan demand from creditworthy customers or potential customers in a community and the difficulty of determining in a cost-effective way the distribution throughout a bank's community of the various types of credit extended by the bank, including the distribution in areas that might be considered low- and moderate-income. We are currently working on an interagency basis to develop better tools for geocoding loans, obtain more current data on neighborhoods (which now will likely have to await the results of the 1980 census) and improve generally the process of assessing an institution's lending performance in its community. Again, the inadequacies perceived by the GAO in assessment methods we believe are more a function of the difficulties inherent in the process rather than any failure of emphasis or lack of commitment.

4. The first paragraph on page 7 states that "some managers and examiners said they did not personally agree with the purpose and need for some of the laws."

We are not sure we perceive the relevance of this remark apart from suggesting a lack of commitment on the part of some staff. It is certainly not unusual for staff in any organized effort to have personal views regarding the work they do. We are confident that our examiners and staff, regardless of their personal views which no doubt vary, especially with regard to something as controversial as truth in lending, are sufficiently professional to carry out their duties in a responsible and effective manner.

5. The first paragraph on page 7 goes on to state: "Some managers and examiners who might have been responsive said they received no support from top management."

We are not sure of the nature of the "support" that was allegedly denied or the circumstances in which it was supposedly denied or indeed even the agency or time frame in which it was reportedly denied. We can assure the GAO, however, that the FDIC's Board of Directors and "top management" are firmly committed to a vigorous and effective compliance examination and enforcement program and that staff is constantly working to upgrade the program and improve results.

6. We are not sure of the meaning and import of the first full paragraph on page 7. We do not agree, for example, with the first sentence which suggests there is a necessary conflict between the enforcement of consumer credit protection laws and regulations and traditional safety and soundness considerations. The agencies and their examiners have traditionally enforced a variety of laws applicable to financial institutions. In addition, through vigorous and effective enforcement of consumer credit laws, the agencies not only assure to consumers the protections to which they are entitled but also minimize the institutions' exposure to possible civil liability and penalties and thereby serve traditional safety and soundness ends as well. As a result, we find traditional safety and soundness concerns perfectly compatible with enforcement of consumer credit protection laws and regulations.

We also object to the suggestion raised by the example that our examiners have traditionally downgraded the quality of loans in socially and racially mixed neighborhoods. This is certainly not our present approach and to our knowledge, particularly since the passage of the Fair Housing Act, we have issued no instructions to examiners or policy directives suggesting that the social or racial mix of a neighborhood was a basis for downgrading the quality of a loan. Indeed, the FDIC's Board of Directors, in recently denying a branch application by a New Jersey bank, noted that the bank had excluded from its lending area a low- and moderate-income community with a relatively high percentage of minority residents.

7. The penultimate paragraph on page 7 alludes to managers and examiners commenting that "financial safety and soundness was the principal responsibility of their agencies and that consumer law compliance was of lesser importance." It also mentions a 1979 survey in which banking agency managers and examiners considered consumer law compliance the least important of eleven examination functions.

We question the meaning of those observations since we are inclined to suspect that the comments regarding the "principal" functions of the agencies reflect in large part the obvious fact that most of the agencies' resources and efforts are directed to safety and soundness. In addition, any ranking scheme means that some functions must necessarily follow others in importance and yet the order of ranking says nothing about the absolute importance of even the last-ranked function.

8. The last sentence on page 7 carrying over to page 8 refers to the relationship between the agencies and the institutions in the safety and soundness area as being one of "consultant/advisor."

We regard our relationship with the insured nonmember banks we supervise as being considerably more than "consultant/advisor" and all the term implies by way of freedom to pick and choose and/or ignore recommendations and requests. We view our relationship instead as one of "regulator/supervisor," meaning simply that we will first try to obtain necessary corrective action on a cooperative, voluntary basis but, if unsuccessful in this effort, we will not hesitate to resort to legal compulsion to correct unsafe or unsound conditions, practices or violations of law, including consumer law violations.

9. The first full paragraph on page 9 states that the Flood Disaster Protection Act was addressed by most, but not all agencies and regions.

Insofar as FDIC is concerned, the Flood Disaster Protection Act was addressed during the course of safety and soundness examinations until February of 1980 when responsibility was shifted to the compliance examination program to better align it with the jurisdiction of the Consumer Compliance Task Force of the Examination Council.

10. The first full paragraph on page 9 also states that "Almost uniformly, none of the agencies addressed the applicable provisions of the relatively new Electronic Funds Transfer Act and the Right to Financial Privacy Act . . ."

With regard to the EFT Act, there was relatively little to examine for at the time since only two provisions were applicable, one of which only applied in the context of civil litigation, and the bulk of the implementing Regulation E was yet to come. Similarly, with regard to the Right to Financial Privacy Act, relatively few provisions impose obligations on financial institutions since the bulk of the requirements and the major thrust of this legislation are designed to control the manner in which government agencies obtain and share information contained in the records of financial institutions.

11. The second full paragraph on page 9 alludes to differences in the average length of FDIC compliance examinations in different regions and mentions in particular the FDIC's Atlanta region averaging 17 hours per examination while FDIC's Philadelphia and Richmond regions average 106 and 108 respectively.

With regard to the relatively short average duration of compliance examinations in FDIC's Atlanta region, it must be remembered that this region includes many relatively small institutions. In addition, the Atlanta Region at the time was conducting many limited scope examinations as a means of following up on the results of prior examinations.

12. The last paragraph on page 9 states that the GAO's comparison of examination results among agencies and by agency from one examination to the next showed that the number of hours expended and the number of different violations reported were inconsistent.

We are not surprised by the absence of an easy correlation since increased time may be affected as much by the discovery of greater numbers of the same types of violations as by the discovery of different types of violations.

13. The second full paragraph on page 12 states that, as part of the equal credit opportunity portion of examinations, "Examiners performed little analyses of accepted versus rejected loans and generally only reviewed institutions' forms and talked to institutions' management."

Our examiners have been instructed and taught to review samples of accepted and rejected loans as well as policies, practices and forms although sample size and manner of review has largely been left to the judgment and discretion of the individual examiner. As indicated in comment 3 above, we are beginning to experiment with a more definite and structured approach to analyzing accepted and rejected loans and are requiring that these procedures be appropriately documented.

14. The first sentence on page 14 states that agency examiners generally did not verify the accuracy of HMDA data.

In this regard, we are also beginning to experiment with a prescribed method of testing the accuracy of HMDA data by tracing the entry of specific loans into the totals reflected on a bank's mortgage loan disclosure statement.

15. The first full paragraph on page 14 indicates that the GAO's conclusions regarding inadequacies in equal credit opportunity and community reinvestment examinations are based principally on the lack of documented analysis.

While we must admit to certain reservations in principle regarding the need to create a paper trail to establish work performance, we agree that, for the time being at least until results have improved and work habits are ingrained, there is a need to document the analyses performed to facilitate review and evaluation.

16. The first paragraph on page 15 states that "Often monitoring data was not maintained by institutions or, if available, was not used by the agencies to evaluate for discrimination."

At the time of the GAO's review, the FDIC was developing a computerized data collection and analysis system utilizing monitoring data. This system, designated COMPASS, has recently been implemented and is expected to be an important tool for isolating possible cases of discrimination.

17. The second paragraph on page 15 states that "In no instances, did we find examiners using data other than institution records to assess compliance. For example, no discussions were held with community groups or leaders to determine needs and institutions efforts to meet these needs."

As part of an interagency effort, the FDIC in January of this year issued a directive to its Regional Offices encouraging outside examiner contacts during regular compliance examinations. Specifically, the directive called for the following contacts:

> "Any person or organization that has, in a CRA comment to the public file, specifically requested to speak to an examiner;
>
> "Any person or organization that has raised a substantial issue in a CRA comment letter which requires further explanation and/or verification--such persons or organizations should be contacted even where they have not made a specific request for a meeting; and
>
> "A representative sample of persons or organizations with whom the lender has said it communicated--this form of outside contact would normally be made only in circumstances where the examiner or other agency representative determined a need to independently verify the lender's performance in ascertaining local credit needs."

More recently, we have issued another directive encouraging even wider outside examiner contacts whenever valuable information is likely to be provided concerning either the credit needs of a bank's community, its efforts to ascertain those needs and make known its credit services, or its efforts to meet community credit needs.

18. The third paragraph on page 15 defines substantive CRA violations as "failure to support community lending principles."

Given the generality and vagueness of this concept, we question its usefulness in attempting to isolate substantive CRA violations. In a strict sense, virtually every bank extends much, if not most, of its credit in its local community and thus "support" for "community lending principles" in virtually every case is a matter of degree. In reality, fair and accurate CRA assessments involve complex judgments and determinations regarding the nature and extent of community credit needs and the bank's efforts to ascertain and satisfy those needs within the confines of safe and sound banking. We do not perceive "support of community lending principles" as a viable criterion for assessing performance in meeting community credit needs.

19. The first full paragraph on page 17 discusses the educational efforts of the agencies and omits mention of the FDIC's consumer compliance seminars which began shortly after the original period of the GAO's review. These seminars are one-day educational efforts designed to meet the specific needs and concerns of the bankers attending in order to assist them in meeting their compliance responsibilities. To date, the FDIC has conducted over 40 seminars in different parts of the country.

20. The second full paragraph on page 17 again alludes to agencies' "focus" and "emphasis" on discovering technical violations.

As indicated in comment 1 above, we reject the notion that the agencies have emphasized technicalities.

21. In the middle of page 19, there is cited the example of an examiner who opined that he would be reluctant during a six-month detail to criticize bank managers for consumer law violations if he had to return to examine the bank for safety and soundness for several years to come.

We are inclined to view this examiner as atypical and one who has perhaps chosen the wrong profession since warranted criticism is at the very heart of the examination and supervisory process, both with regard to consumer and safety and soundness matters.

22. The first paragraph on page 20 alludes to examiners expressing concerns regarding limited career opportunities in the consumer law area.

We are aware of these concerns and are working to change these perceptions. We believe we currently have a reasonably attractive grade structure in the consumer area and in the last year have appointed three Assistant Regional Directors with consumer compliance backgrounds.

23. The first full paragraph on page 21 describes training as focusing on the requirements of the laws with less attention given to the techniques necessary to examine for compliance.

While there is some merit in this observation, it should also be remembered that, insofar as the FDIC is concerned, our compliance examinations are conducted or overseen by commissioned examiners at the GG-11 level and above. These individuals have had years of experience and demonstrated their competence in bank examination and supervision. As a group, we believe they possess the initiative, experience and judgment necessary to review relevant activities for compliance with laws. As indicated above, however, we are, in an effort to strengthen examination techniques, experimenting with more definite and structured approaches to examining for compliance with equal credit opportunity proscriptions.

24. The second full paragraph on page 21 mentions some so-called unique actions recommended by the agencies. These include anonymously calling the bank under examination to test for prescreening and correct quotation of annual percentage rates and "discreetly overhearing" receptionists and loan officers to detect prescreening and discrimination.

For the record, the FDIC has issued no directives authorizing these actions and certainly does not condone eavesdropping on private conversations.

25. The last paragraph on page 22 states that, in most cases, the agencies' procedures do not describe and require structured comparison and analysis of accepted versus rejected loans, analysis of monitoring information required for real estate-related loans, comparison of accepted and rejected loans to stated lending policies, and comparing HMDA data to an institution's delineated lending area (geocoding).

We have recently adopted on an experimental basis uniform procedures that include the types of analyses outlined. These procedures will be evaluated in approximately 90 days for effectiveness as well as cost, and revised or modified as appropriate.

26. The first sentence of the first full paragraph on page 23 states that the FDIC, among others, does not have procedures requiring that work be fully documented.

The experimental procedures mentioned above in comment 25 include requirements for appropriate documentation. While we have certain reservations regarding the creation of workpapers as discussed in comment 15 above, we agree that such documentation is necessary, at least until newly-prescribed procedures are proven effective and become firmly established.

27. The penultimate paragraph on page 23 refers to the FDIC's inquiry log as requiring the recording of "telephonic" as well as in-person inquiries for loans.

The FDIC's regulations do not require the recording of telephonic inquiries--only written or oral in-person inquiries.

28. The penultimate paragraph on page 26 suggests the assignment of examiners to the compliance examination function for an extended rotation of 18 to 24 months may be more desirable than a career commitment.

While we agree with the need for permanence and continuity in the compliance examination function, we perceive considerable disadvantages (in terms of commitment, fairness and morale) to involuntarily assigning relatively few selected examiners to the compliance examination function for rather lengthy terms. At the present, we believe a career commitment to compliance as an examiner specialty is the best staffing alternative available and it is the one we are pursuing.

29. The last paragraph on page 26 suggests that compliance examinations may be conducted less frequently than the 18-month cycle followed by the FDIC.

We believe this suggestion may have merit in view of current staffing constraints. However, we have been reluctant thus far to shift to a longer examination cycle in view of the volume of violations currently being uncovered and the number of banks involved. This experience suggests that stretching out the examination cycle at this time may be premature. Furthermore, the addition of new regulations such as EFT Regulation E, and the revision of existing regulations, such as TIL Regulation Z, argue in favor of more frequent examinations.

30. The second paragraph on page 27 suggests the other agencies become "involved" in the work of the OCC's task force on consumer examinations.

We are not sure what type of involvement is suggested in an internal working group of another agency. We are, of course, interested in their work and would expect the OCC will share with the other agencies the final conclusions and recommendations of its working group.

31. The second sentence on page 29 alludes to "The agencies' failure to enforce compliance with consumer laws . . ."

On its face, the statement is inaccurate at best since it suggests a complete failure to enforce. No doubt what is intended is the charge that the agencies often do not enforce compliance against those institutions that do not voluntarily comply. The assumption is that the point at which voluntary compliance is not being achieved is clear and that unlimited resources are available to compel compliance by legal proceedings, neither of which assumptions is true. In point of fact, legal proceedings are quite expensive, involving considerable examiner and attorney resources as well as the time and attention of regional managers, senior staff at the Washington Office level and the Board of Directors of the FDIC. It makes little sense in our view to pursue in a legal proceeding results that can be obtained on a voluntary basis. Similarly, it is seldom clear at what point efforts to obtain voluntary compliance have failed. Frequently, with some additional supervisory pressures brought to bear over a period of time, the desired corrections are in fact obtained. In this regard, it should be pointed out that the supervisory process is flexible and requires considerable judgment in light of the unique circumstances in each case. The process may take some time but, by and large, it is quite effective in bringing about corrections on a broad scale in the industry. As the Supreme Court noted in

United States v. Philadelphia National Bank, 374 U.S. 321, 329 (1963), ". . . recommendations by the agencies concerning banking practices tend to be followed by bankers without the necessity of formal compliance proceedings."

32. The last sentence of the first paragraph on page 29 alludes to the need for "standard enforcement criteria supported by top management."

With regard to two of the major areas covered by the compliance examination program, namely truth in lending and equal credit opportunity, there is currently in place a policy guide setting forth uniform interagency standards for truth in lending enforcement and comparable guidelines for equal credit opportunity are in the final stages of development. We anticipate these will be adopted in the near future. These standards have been or will be adopted by the heads of the respective agencies and so they have and will have the support of top management.

33. The second paragraph on page 29 states that "Although consumer credit protection laws have been in effect for several years, most financial institutions continue to be cited for noncompliance with some portion of these laws."

We do not find this observation surprising given the number of laws and regulations involved, their complexity (particularly truth in lending), the numerous, often detailed, requirements and proscriptions involved, the number of transactions and events covered and the possibilities of human error.

34. The last sentence of the second paragraph states that "the regulators' failure to make institutions correct violative practices accounts for a major portion of the industries continuing violations."

This is a gross overstatement at best. The bulk of the violations in the industries, including those the GAO might characterize as "continuing," are simply and basically the result of the number of laws, the number and complexity of the requirements, the number of creditors, large and small, involved, their relative sophistication and the resources they have available to devote to compliance and the sheer number of transactions and events covered by the laws and regulations. Moreover, we believe we have been successful in most cases in correcting violative practices although, as discussed above, the point at which voluntary efforts fail and legal proceedings are necessary may be argued.

35. The last sentence on page 29 states that "23 percent of the violations cited in the second most recent report were cited again in the most recent examination report."

This statement is not entirely clear and could be very misleading. For example, an APR violation may be cited from one examination to the next and yet there are any number of ways in which an APR may be incorrectly computed and disclosed. Similarly, a practice may have been corrected following a prior examination and yet an isolated violation of the same type may be detected at the next succeeding examination, resulting in a continuation of the same type of violation from one examination to the next. This same observation may be made regarding the statement at the top of page 30 that "a few institutions continued the same violation through three consecutive examinations." Furthermore, insofar as truth in lending is concerned, the FDIC had been sampling, for the first round of examinations under the original Regulation Z reimbursement guidelines, transactions that occurred since October 28, 1974. As a result, reported violations may have occurred during earlier periods seemingly covered by prior examinations.

36. The first full sentence at the top of page 30 also includes the statement that "about half of the institutions continued to violate at least one of the laws" from one examination to the next.

Again, this is not a surprising finding given the number and complexity of the requirements imposed under each of the different laws and regulations and the number of transactions to which they apply.

37. The comments above regarding repeat violations continuing from one examination to the next are applicable as well to the horror-story situations described in the last paragraph on page 30. The conclusion at the bottom of page 30 that the agency should have done more to either assist or monitor corrective action in these situations should be placed in context by bearing in mind the numbers of institutions that must be supervised by the particular regional offices and the practical need to rely to a considerable extent on what may have appeared on its face to be good faith representations on the part of the institutions that corrective action had been accomplished.

38. The last paragraph on page 31 states in effect that regardless of the significance or persistence of the violation, the agencies relied primarily on moral suasion and accepted compliance to the extent institutions voluntarily responded to this technique.

We believe this is a sound approach in principle since we see no need for legal proceedings to accomplish what can be accomplished voluntarily through moral suasion and negotiation. Only when such voluntary efforts fail should resort be made to stronger supervisory pressures and legal proceedings should be instituted only as a last resort.

39. The last sentence of the first paragraph on page 32 mentions a case in which only a few violations were cited in the most recent examination and no enforcement action was taken because regional management considered the institution "clean."

Again, the disclosed facts alone may be misleading since it seems quite possible that the few violations noted were isolated, inadvertent violations of a "technical" nature or were corrected during the course of the examination in which event no additional enforcement action would seem appropriate.

40. The second paragraph on page 32 states in essence that the agencies generally continued to rely on moral suasion to correct the problem when an institution continued to "violate a law" from one examination to the next.

# EXAMINATIONS OF FINANCIAL INSTITUTIONS DO NOT ASSURE COMPLIANCE WITH CONSUMER CREDIT LAWS

## COVER SUMMARY

Financial regulatory agencies' programs for enforcing consumer credit protection laws were inconsistent and, for the substantive aspects of some laws, inadequate. As a result, consumers have not been assured consistent protection, and financial institutions have not been treated equally.

GAO recommends that regulators modify their programs to emphasize the substantive principles of consumer credit laws. Regulators should reassess the objectives of compliance examinations, continue plans to recruit and train specialized examiners, adopt uniform detailed examination procedures, and establish uniform standards for enforcing compliance with consumer credit laws.

Again, given the number of provisions of "a law" which an institution could violate, the variety of ways in which such volations might occur and the opportunities for violations, e.g., number of consumer credit transactions subject to the requirements, it seems entirely appropriate that moral suasion would continue to be used so long as the institution was cooperating in good faith to make the necessary corrections voluntarily.

41. The last paragraph on page 32 states that "FDIC has had a problem list for a number of years, but at the time of our review it was not current and was not being used for monitoring purposes."

As a point of clarification, the FDIC's problem list is continuously updated as compliance reports are reviewed in the Washington Office. At the time of the GAO's review, the list was not current with additions and deletions due to a temporary backlog of compliance reports in the Washington Office. The list was, however, being used for monitoring purposes.

42. The first full sentence of the second full paragraph on page 35 states that "Financial institutions that do comply are penalized in the sense that they are treated no differently than institutions that do not comply."

The "no different treatment" is a gross exaggeration at best. Even by the GAO's account (see the second paragraph on page 32), the agencies follow up on violations and take more aggressive action in some cases of continuing violations.

The second sentence of the same paragraph states that "Institutions generally complying with the laws are examined, a form of regulatory burden, as often as their counterparts who do not comply."

This statement is not true insofar as the FDIC is concerned since follow-up visitations and accelerated re-examinations are a routine part of the FDIC's examination and enforcement program.

43. The penultimate paragraph on page 35 contains the sentence, "The agencies, because of the controversies concerning the laws and the complexities of some of the laws, have not emphasized the strong enforcement of consumer compliance."

While it may be true that some agencies have been slow to fully come to grips with their consumer enforcement responsibilities, the reasons cited by the GAO have not been significant considerations. In reality, to the extent the agencies have been slow, it is attributable to the rapid growth in consumer protection legislation and some failure to fully appreciate the scope and complexities of the new enforcement responsibilities and to staff and plan accordingly. These shortcomings are rapidly being corrected although with some difficulty given current staffing limitations and the need to allocate staff time to various interagency initiatives.

44. The first full paragraph on page 36 contains the statement, "Agencies management had not issued directives emphasizing strong enforcement . . ."

In order to place this conclusion in perspective, it is appropriate to note, for example, that the FDIC in August of 1979 issued a directive to its Regional Offices requiring, as part of the follow-up of the results of compliance examinations, that the letters transmitting the reports to the boards of directors of the banks involved emphasize the collective and individual responsibility of board members to operate the bank in compliance with law and regulations, including consumer regulations. The directive went on to state:

> "The letters should request at a minimum that the bank promptly implement corrective measures designed to avoid any further repetition of the violations cited in the report and a response indicating the specific steps the bank has taken or will take to avoid any further repetition of the violations. The bank should also be requested to specify definite time frames within which it might reasonably be expected to accomplish the necessary corrective action and to advise the Regional Office after it has done so. Each letter should specifically request that the compliance report be reviewed by the board at its next meeting and its action thereon noted in the minutes of the meeting
>
> "The Regional Office should insist that bank responses to compliance reports and transmittal letters be specific and definite with respect to the corrective action taken or planned by the bank and include specific time frames for the accomplishment of any promised remedial action. Response letters which are vague and indefinite or which do not include specific time frames for the accomplishment of future corrective action should be followed up with a request for more precise and definite information."

In addition, in December of 1979, the FDIC issued a directive to its Regional Offices establishing a compliance rating system and requiring, with respect to banks rated 3, 4 or 5 (in the less-than-satisfactory range), that either an informal agreement be concluded, a formal cease-and-desist proceeding be instituted or an explanation be furnished the Washington Office as to why neither of these courses of action was being pursued.

More recently, in June of this year, a directive was issued to the Regional Offices specifying that any application received from a bank designated a compliance problem ordinarily should not be approved by the Regional Director under delegated authority without the applicant bank first having taken definite and positive steps to correct its compliance deficiencies.

45. In the second paragraph on page 37, the GAO opines that an effective enforcement program should consider prior examination results "to emphasize repeating violations."

While the continuation of a practice in violation of a law or regulation is certainly an important enforcement consideration, we believe it would be a mistake to focus too narrowly on a single factor. In our view, the composite of circumstances in each case should be considered in deciding the appropriate course of enforcement action. Again, our comments 35 and 36 above concerning the presence of "repeat" violations are relevant here as well.

46. The second paragraph on page 37 also mentions a region in which the GAO's review revealed that a number of recurring violations were not specifically identified as such in either the examination report or accompanying transmittal letter to the institution.

Insofar as the FDIC is concerned, we have issued a directive, outstanding since August 1979, that repeat violations are to be prominently noted on the first page of our compliance reports. This page summarizes the examiner's findings, conclusions and recommendations.

47. The last paragraph on page 37 begins with the statement that "Prioritizing and scheduling consumer examinations often has been determined by factors unrelated to the achievement of consumer compliance" and goes on to offer the FDIC's 18-month examination cycle as an example.

Although opinion may differ regarding the ideal or optimum examination frequency, we believe there is merit in a regularly recurring pattern of consumer compliance examinations and we are at a loss to understand how such a regular program of examinations can be characterized as "unrelated to the achievement of consumer compliance." As indicated in our comment 29 above, we are considering the question of frequency and may, in the future, extend the cycle somewhat.

Insofar as "prioritizing" consumer examinations is concerned, see also our comment 42 above wherein we indicate that follow-up visitations and accelerated re-examinations are a routine part of the FDIC's compliance examination and enforcement program.

48. The second full paragraph on page 38 states that "When moral suasion was not effective, the agencies did not generally use stronger enforcement measures and were not effective in achieving compliance."

We believe the FDIC has been using and generally does use stronger enforcement measures when moral suasion fails. Similarly, we believe we have generally been effective in achieving compliance by resort as necessary to formal cease-and-desist actions.

49. The third full paragraph on page 38 states that "those institutions that complied with the laws were treated no better than those that did not comply."

Again, we disagree with this conclusion. Banks subject to the FDIC's jurisdiction are subjected to increasing supervisory pressures ranging from additional examiners visits and meetings with boards of directors up to and including informal written agreements and formal enforcement actions when they do not comply voluntarily. Even the GAO noted on page 34 that the FDIC had issued 13 cease-and-desist orders to compel correction of consumer law violations.

50. The fourth full paragraph on page 38 begins with the statement that "Financial institutions that have tried to comply with the laws are necessarily burdened with additional regulatory requirements."

We disagree with this conclusion since in our view most banks have tried to comply, some albeit more successfully than others, and those that have been less successful are in fact subjected to increasing supervisory pressures to comply.

51. The last paragraph on page 38 begins with the statement "The agencies' regional managers who have front line responsibility for supervising compliance had no standards for initiating enforcement actions . . ."

We do not share the GAO's preoccupation with standards in this area since in our view what is required are not hard-and-fast rules but responsible judgments based on the composite of circumstances in each case. These judgments we believe our Regional Directors are amply qualified to make.

The same sentence goes on to state that agencies' regional managers "received no encouragement from the agencies' top management to emphasize enforcement."

We are not sure what type of encouragement the GAO believes "top management" should have given their regional managers to do their jobs. Certainly, there has never been any suggestion that enforcement should not occur and, in terms of "emphasis," we do not believe the consumer compliance function can be viewed in isolation but must be considered in the context of the other programs managed by the agency. When considered in this light, we believe that consumer compliance, at the FDIC at least, has received considerable "emphasis."

52. The last sentence on page 38 states that "Factors such as the institution's financial condition entered into the decision-making process resulting in inconsistent enforcement."

Fortunately, the financial condition of an institution is an infrequent consideration in compliance enforcement actions. Where it is a factor, however, it is usually related to management's ability to deal with a range of problems, both in the safety and soundness and consumer compliance areas. In these situations, we believe it appropriate to consider the order in which the problems can realistically be addressed and to perhaps deal with safety and soundness issues first. Moreover, although admittedly in a somewhat different context, the Congress apparently agrees that financial condition is an appropriate consideration since it recently provided in section 608 of the Truth in Lending Simplification and Reform Act that the agencies are to consider financial condition when requiring reimbursements for truth in lending violations.

Mr. William J. Anderson
October 24, 1980

53. We basically agree with the recommendations contained in the second paragraph on page 39. As a broad statement of principle and direction, we believe they are sound. We might note in this regard that the agencies currently have uniform truth in lending enforcement standards, expect to soon have equal credit opportunity enforcement standards, and are continuing initiatives towards greater interagency uniformity in a number of other areas of their consumer compliance programs.

54. With regard to the recommendations contained in the last paragraph on page 39, we believe there is at least some question as to whether the Federal Reserve Board has the requisite legal authority to prescribe by regulation specific enforcement standards and penalties and, by implication, circumscribe the power of the other agencies to exercise their own enforcement authority in a discretionary manner and fashion remedies as the circumstances may warrant in particular cases. Apart from any question of legality, however, we believe the approach recommended is undesirable in any event since we believe it much better to develop standards and remedies, as needed, on an interagency basis, drawing upon the experience of all of the agencies and taking into account the unique circumstances and practices of the industries they regulate.

55. The last paragraph on page 41 contains a number of minor errors. Regulation Q does not govern consumer credit activities. The FDIC and OCC also have consumer complaint-handling responsibilities under the FTC Improvements Act (in addition to the FRS). The Preservation of Consumers' Claims and Defenses "Act" is not a statute but rather an FTC Trade Regulation Rule. Also, NOW account legislation basically authorizes a form of checking on interest-bearing accounts. Regulation Q and FDIC Part 329 regulate interest on time and savings deposits in insured banks.

We trust the foregoing comments are helpful in making whatever final changes or revisions are necessary.

Sincerely,

Irvine H. Sprague
Chairman

**Federal Home Loan Bank Board**

JAY JANIS
Chairman

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

OCT 29 1980

Mr. William J. Anderson, Director
General Government Division
United States Government Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

As requested by your September 26, 1980 letter, I am providing the Federal Home Loan Bank Board's views and comments relating to GAO's draft report entitled "Financial Institution Regulators Needs to Focus on Substantive Principles of Consumer Legislation During Compliance Examinations."

Apparently GAO believes that because the Board has not found a large number of enforcement cases, the Board examination process does not focus on substantive issues of consumer legislation. GAO fails to recognize that the lack of enforcement cases may well indicate that savings and loan associations have made and are continuing to make every effort to comply with those substantive principles. Insofar as savings and loans are concerned, the record and experience of the Board do not support GAO's conclusion. Further, we can find no factual support for GAO's conclusion in the draft report.

As the draft report shows, examination procedures have detected noncompliance with technical provisions of some statutes. However, the thrust of these procedures are intended and designed to disclose substantive violations. The fact that there are relatively few instances of such violations shows that the institutions supervised by the Board are making reasonable efforts to meet the credit needs of their communities and to comply with the spirit and intent of consumer legislation. The Board believes that it can sustain its position in this matter. The GAO report contains no evidence which would cause us to change that belief.

Despite the fact that pages 19 and 20 of the report disclose that agencies which have established separate consumer examinations have encountered problems and created resource and staffing difficulties, it is clear that GAO has a strong bias in favor of this type of examination. As GAO knows, the Board has considered this issue from the viewpoint of practicality, impact on existing and future staffing and other resource requirements, examination and administrative requirements, and the burden and cost to the industry. We remain unconvinced that separate consumer examinations will be more effective. The GAO draft report adopts the current trend of attempting to distinguish between safety and soundness examinations and consumer examinations. It is our contention that consumer matters are an important element of safety and soundness. Attempting to distinguish between the two elements tends to relegate consumer matters to a second-class status. At page 19, the report expresses the opinion that our program results in consumer matters not receiving highest priority. We do not dispute this. We do point out that nowhere in the report is there evidence that our examinations do not give equal priority to consumer matters.

Equally important is the fact that insofar as examinations of savings and loans are concerned, having two types of examinations would involve a substantial duplication of work. The burden and cost of the duplicative effort would fall on the Board and the industry. We cannot justify this. Unlike some other financial institutions, a savings and loan association is involved basically only in mortgage lending. Further, such lending generally involves those who are covered by mortgage-lending consumer legislation. An examination of mortgage lending for either safety and soundness or consumer matters essentially involves a comprehensive review of mortgage lending policies, practices, activity and files and related records. To adequately review consumer compliance at the time of our regular examination admittedly adds to the overall examination time. However, this additional time and cost is insignificant in relation to the time and cost which would be involved in two separate types of examinations. Further, as the draft report recognizes, having two types of examinations does impose an extra burden on the institutions.

We are concerned that because the draft report expresses unsupported conclusions or fails to take into account current activities which were described to GAO's representatives, the report's conclusions tend to be either argumentative or inappropriate to the current operations of this agency. A few examples of causes of concern to us follow.

Page 8: "Inconsistencies"

Beginning at this page and continuing to page 10, the report contains a confusing and, in our opinion, irrelevant description of varying amounts of time expended by various agencies in examining for consumer matters in an effort to show that there are "inconsistencies."

GAO has failed to consider and make allowance for the varying responsibilities of each agency and, more importantly, fails to recognize that all of the institutions are not of the same type and offer different services. For example, in a savings and loan, the major portion of time required to determine TIL compliance will consist basically of determining whether APR's are computed correctly on mortgage transactions. Thus, our examiner will be dealing with a single type of lending transaction. Banking institutions will have a variety of lending services. While mortgage lending may be one of these services, it usually will not be the major service. A similar difference will exist with credit unions. Given the fact of the variations in the types of lending, we fail to see how a comparison of time between all types of institutions represents a relevant, meaningful analysis of the quality of work.

Page 11: "Variations in the type and quality of analyses performed"

The report comments cannot be related to any specific problems or agency failures. Our examiners perform an in-depth review of mortgage lending, much of which has a bearing on compliance with consumer matters. It may be that since we do not have a separate consumer examination with a separate set of workpapers, GAO may have overlooked the need to review all examination workpapers rather than just those identified as relating only to consumer matters. Further, a prime source of data, the Loan Application Register, is retained by the institution.

Admittedly, the extent and depth of our analysis of any phase of an examination will vary, depending in part on the examiner's skills and knowledge, but mostly on need. Our examination processes are geared to a minimum scope which must be expanded when the need to do so is disclosed. GAO's remarks concerning the lack of certain analyses fail to show that in any specific cases, such analyses were required.

Page 12: "The agencies' examinations of the more difficult to assess and more time consuming substantive principals of...CRA... were uniformly inadequate."

Page 13: "For...CRA, our sample results were insufficient to be conclusive because...CRA is relatively new legislation."

Obviously, the statement at page 13 completely destroys the validity of the conclusion expressed at page 12.

Page 13: "FHLBS did not emphasize TIL as part of their consumer compliance examination."

As was fully discussed with and explained to the GAO's representative, there was a considerable period of time during which there was no clear, official basis for determining the accuracy of the finance charge and the annual percentage rate on several types of mortgage transactions. Once these issues were resolved and uniform enforcement guidelines adopted, the FHLBB provided each examiner with a programmable calculator and conducted a comprehensive 3½ day training course in its use in determining compliance with TIL requirements. As of September 30, 1980, each examiner has received this training. In addition, we provided similar training to nearly 200 state examiners.

Page 17: "The agencies' examination programs are inconsistent because the agencies have not coordinated a uniform approach to examination."

This statement is misleading. It expresses GAO's opinion that there have been no coordinated, uniform approaches. However, at the next page, GAO contradicts itself by conceding that there has been an "attempt" at coordination by the issuance of uniform guidelines for CRA and uniform enforcement standards for TIL. These actions are more than an "attempt." They are proof that the agencies are coordinating their activities so as to assure a uniform approach.

Page 21: "The three banking agencies spend considerable time teaching examiners how to verify annual percentage rate calculations. This was not performed to the same degree by the other two agencies."

As previously discussed, the GAO's representative was advised of the reason for the delay in commencing the FHLBB's training program and of the fact that at the time of that discussion, we were devoting considerable time and effort in teaching our examining staff how to verify annual percentage rate calculations.

Page 23: "FDIC, FHLBS, and NCUA did not have procedures requiring that work be fully documented."

This statement is not correct. All work done by our examiners is fully documented. Further, examination reports and workpapers are reviewed at several levels in order to assure consistent, quality examinations. Again, it appears that GAO has not attempted to relate documentation to the need for review. Obviously, if work is not required, there will be no documentation of that work. However, our workpapers will disclose the examiner's conclusion that further analysis was unnecessary and the basis for that conclusion.

Page 32: "FHLBS also has a system to monitor problem nondiscrimination cases... (but) we found no awareness of such a system in the field offices."

Mr. William J. Anderson

We do not know what procedures were used by GAO to determine the awareness of our field offices of our monitoring of discrimination problems. Nonetheless, we believe that our field office managers are well aware of our monitoring system and its workings, if for no other reason than the Headquarters Office requires regular reports showing the extent of and results achieved in resolving matters of concern.

At page 27, GAO recommends that the agencies "work together under the direction of FFIEC, to develop and administer a consistent, effective consumer law compliance examination program." GAO particularly recommends that the agencies should:

> "Determine and allocate the level of resources necessary to implement uniform examination procedures."

While the Board favors a cooperative effort among all of the regulatory agencies, we do not believe that we can delegate to the Federal Financial Institutions Council, or permit the Council to assume, our responsibility for enforcing compliance with the law, as recommended by the draft report. We will, of course, continue to share our knowledge, experience and expertise in mortgage-lending matters with other agencies, particularly in connection with the activities of the various Council Task Forces.

The Board is of the opinion that by its regulatory examination and data collection and analysis processes, it has developed and is administering consistent, effective consumer law compliance programs that adequately address the substantive principles of the various laws. We have devoted considerable time and effort in providing our examiners, as well as many state examiners, with a sound, effective working knowledge of both the substantive and technical aspects of the consumer protection laws. Examiner career paths include the necessity to properly master and apply this knowledge. In effect, then, we believe that the Board has taken actions which basically conform to the substance of the recommendations in GAO's draft report.

After your review of this letter, if you or your staff wish further discussion of any of our comments, or if any further information is desired, I and my staff will be pleased to accommodate you. Please feel free to direct any such requests to Mr. Charles R. Gillum, Director of our Internal Evaluation and Compliance Office (377-6190).

Sincerely,

Jay Janis

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

October 24, 1980

Mr. William J. Anderson, Director
General Government Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

The Board was pleased to note that the draft report on the federal financial agencies' consumer protection enforcement efforts acknowledged some of the positive steps that the Federal Reserve System has undertaken to enforce consumer protection and civil rights statutes and regulations. These include:

1. Creating a separate career path for consumer compliance examiners comparable to that established for commercial examiners.

2. Creating a manual of examination procedures, checklists and workpapers designed to guide an examiner's efforts in the detection of violations of consumer and civil rights laws and regulations. We believe these materials include the best "state of the art" advice available.

3. Creating and expanding the hours of examiner training programs that are designed to educate the examiners in the requirements of the law and the techniques to use in examining for compliance.

4. Creating an educational/advisory service for all member banks who request advice and assistance in complying with the consumer protection and civil rights laws.

The Board shares GAO's concern about the detection of violations involving discrimination, and we would certainly welcome a thorough analysis of each individual agency's performance in this area for the guidance that would provide us in improving the quality of our program. However, this draft does not provide such guidance with respect to this, a most difficult portion of our examination function.

The Board is troubled, moreover, as to significant aspects of the draft report. The Board believes that it has developed a sound compliance program but that this has not been reflected in the draft report because, for the most

Mr. William J. Anderson

part, all the agencies' programs are treated together. The lack of differentiation among the various agencies' compliance programs seems to us to jeopardize the usefulness of the entire report as a practical audit tool that can point out strengths and weaknesses in a particular agency's program or help to develop uniformity in the policies, procedures or examination techniques among the agencies. If the report had been an analysis of the strengths of the various aspects of the individual agency programs, each agency, including the Federal Reserve, could better evaluate its own program relative to the other agencies and the Congress would have a better understanding of all the programs. This type of assessment would have been particularly useful as a guide in the development of uniform examination and enforcement procedures by the agencies.

The Board made a significant commitment to consumer protection and civil rights enforcement in 1977 when the compliance program was initiated on a pilot basis. It has consistently upgraded this effort since that time. In 1979 the Board made the program permanent and dedicated a significant amount of resources to ensure its success. To improve its efforts in assuring compliance with civil rights statutes, the Board in 1978 retained a consulting firm specializing in civil rights law to recommend new procedures, if needed, to ensure that its examiners utilize the best possible techniques. The firm's study provided the basis for many of the procedures now being utilized by our examiners and a substantial strengthening of our training programs in the area of civil rights law.

The draft report made several points about findings specifically regarding the Federal Reserve's program to which we would like to respond. It indicated that, despite the fact that the Federal Reserve's compliance manual, procedures and examination workpapers are good, some examiners did not use the procedures and workpapers. This is contrary to Board policy and we would appreciate knowing the specifics of these incidents so appropriate action can be taken.

The draft also indicates that the number of violations found is not directly related to the number of hours spent on an examination -- that is, spending more time on an examination does not necessarily result in more violations being discovered. This conclusion is not suprising. There are many variables that determine the number of violations found in a bank besides the time spent looking for them. The bank's size, its commitment to compliance matters, whether it has a compliance officer, whether it has had an educational/advisory service visit, and the types of loans offered will all bear on a bank's compliance posture.

Finally, the draft report takes issue with the fact that a list of problem banks kept by the Board's staff in Washington is not shared with district bank personnel. This list is an internal management tool prepared from information provided by the Reserve Banks. Consequently, it contains no substantive information the Reserve Bank people do not already know. We do recommend that each Reserve Bank maintain such a list for its own internal management purposes.

Mr. William J. Anderson

A number of the specific points made in the draft report are not, we believe, applicable to the Federal Reserve. The Board supports, however, most of your general recommendations for improving the overall compliance enforcement effort and has in fact taken steps to implement most of them. In particular, we support your recommendations to:

1. Reassess the nature and objectives of consumer law compliance examinations and define criteria for examination frequency.

We have been working with the other agencies in the Examination Council's Consumer Compliance Task Force to adopt uniform compliance rating systems similar to those already in use by several agencies, including the Federal Reserve System. The Board has had in existence for several years a means for scheduling examinations of banks based on the institution's record of compliance. We support a comprehensive approach in this area, since institutions with poor compliance records should be subject to closer supervision than institutions with good records of compliance. The adoption of a uniform compliance rating system by the Examination Council should be of assistance in enabling the agencies to jointly adopt and implement uniform criteria for examination frequency.

2. Develop uniform examination procedures and instructions for all consumer laws that detail specific worksteps to assess the substantive as well as the technical provisions of the laws and regulations.

This is the mandate of the Examination Council. The Board has been participating in this group's work, along with the other members of the Council, to develop such uniform procedures. The Council has adopted uniform examination procedures for the Community Reinvestment Act, the Electronic Funds Transfer Act, and the Right to Financial Privacy Act. In addition, work groups have explored the similarities and differences of the agencies' procedures for examining for compliance with ECOA and Truth in Lending with an eye toward making them uniform, and a group is currently working on unifying the Truth in Lending procedures.

3. Determine and allocate the level of resources necessary to implement uniform examination procedures.

The Board, in 1978, prior to the announcement of the establishment of a permanent compliance program, determined the level of resources necessary to fully implement the program. Each Federal Reserve Bank was asked at that time to submit a new budget for the additionl personnel it needed to make the program a success. The Board substantially increased the size of the Compliance Section in the Division of Consumer and Community Affairs during the same period. The review examiners in the Compliance Section spend a significant amount of their time working with staff members of the other agencies on projects for the Examination Council's Consumer Compliance Task Force. These are projects to design uniform examination procedures, enforcement guidelines, training materials and educational material for the public. The Board is fully supportive of this effort.

Mr. William J. Anderson

4. Continue programs providing separate career paths for consumer law compliance examiners, or establish extended staff rotation programs of 18 months or more, to ensure consistent deployment of highly qualified examiners.

Since the consumer compliance program was initiated in 1977 as an experimental program, the Board has believed that separate compliance examinations are necessary and that they should be performed by examiners who are highly qualified and skilled in consumer protection laws and examinations. The Board has promoted the concept of separate career paths for consumer compliance examiners equivalent to those for commercial, trust and other examiners. In its February 1979 announcement of the establishment of the permanent compliance program, the Board reiterated its support for separate career paths for compliance examiners. It has been our experience that a firm commitment to a separate career path where examiners are promoted according to merit and where they have the support of top management in carrying out their assigned duties is the best method of assuring the creation of a cadre of these highly skilled compliance examiners. The Board ensures that this policy is adhered to by periodic reviews of the Reserve Banks' operations.

5. Place more emphasis on examination techniques to assess the substantive issues of the laws and regulations in the consolidated training program for consumer law compliance examiners.

Board staff has participated extensively in the drafting of lesson plans and case studies to be used in the new Consumer Compliance Examiner Training Program conducted by the Examination Council. The Board during the past year has also conducted seminars for its senior compliance examiners regarding examination procedures that can be used to detect hard-to-find violations of consumer and civil rights statutes. We will continue to work with the other members of the Examination Council to assure that compliance examiners are trained in the most up to date examination techniques as well as being provided with the best training in the substance of the laws and regulations which they enforce.

5. Under the direction of the FFIEC, establish and use uniform enforcement standards for violations of consumer laws.

One of the purposes of the Examination Council is to accomplish that task and the Board is fully supportive of that goal. We will continue to work with the other agencies toward accomplishing that objective. A uniform enforcement policy for the Truth in Lending Act is already in place, and one is now being developed for violations involving the Equal Credit Opportunity Act and the Fair Housing Act.

We cannot, however, support your final recommendation that:

**The Federal Reserve Board amend all existing regulations to clearly state these enforcement standards and include penalties that will be applied consistently for noncompliance, and also include enforcement standards and specific penalties for noncompliance in all future regulations.**

Mr. William J. Anderson

The Board believes that undertaking this recommendation would interfere with the functions and duties of the Examination Council in this same sphere. Additionally, it apears that Congress would have to amend several of the statutes to allow the Board to specify the enforcement action other agencies must use in their supervisory responsibilities, since these statutes specifically allow the various agencies to design their own enforcement procedures.

In closing, we have confidence in our ability to do a good job in performing our consumer protection function. While we agree that improvements could be made, we would find it helpful if the report were to focus more specifically on the strengths and weaknesses of the individual agencies.

Sincerely,

Theodore E. Allison

Theodore E. Allison
Secretary

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON D.C. 20456

CA/HJB:fns
SSIC 1130

Mr. William J. Anderson, Director
General Government Division
United States Government Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

This is in response to your letter of September 26, 1980, and its enclosed draft report entitled "Financial Institution Regulators Need to Focus on Substantive Principles of Consumer Legislation During Compliance Examinations."

I am particularly pleased to be able to report that the National Credit Union Administration has been able to significantly expand and improve its consumer law enforcement program in the twelve months that have elapsed since your field audit of this activity. This progress has been due in part to support which we received from your staff's preliminary audit findings. We truly appreciated the candor and spirit of understanding which your staff exhibited.

In line with your recommendations, NCUA initiated, effective June 30, 1980, separate consumer compliance examinations by specially trained consumer examiners who have a clearly identified career ladder and report directly to a regional Chief of Consumer Affairs. They have a Consumer Examiner's Guide and a wide variety of specially developed workpapers. Our enforcement program also includes strong emphasis on the continuing education of credit union officials to help ensure their compliance with both "substantive" and "technical" requirements of the law.

In general we concur with your observations as they applied to conditions existing in mid-1979. This was, however, early in the functioning of the Federal Financial Institution Examination Council and its Consumer Compliance Task Force. Also, it was prior to the establishment of the interagency consumer examiner training course and NCUA's separate consumer compliance examination program.

The subject of interagency consistency and cooperation has been addressed in the FFIEC's reply to your proposed report. We would like to comment, however, that in our opinion the term "uniformity" would be a more accurate one to use than "consistently" in Chapter 2. We would also like to comment that credit unions, as cooperatives, are a far different type operation than banks in size, complexity and philosophy. Generally speaking, they offer a very different approach to credit extensions. Hence, the concept of total uniformity in enforcement procedures is not realistic.

Also in this regard we note that a significant percentage of creditors are not examined for compliance with Federal consumer laws by Federal regulators and

NATIONAL CREDIT UNION ADMINISTRATION
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thus were not within the scope of your proposed report. This includes finance companies, retailers and State chartered credit unions. We believe that the concept of "consistency" in your report should be viewed accordingly.

The subject of "substantive principles" is of great concern to us. We are making every attempt in our new separate compliance examination program to assure that compliance with the fundamental principles of the consumer laws are achieved, particularly by emphasizing effective examination techniques in our consumer examiner training.

In addition, it is our observation that "technical" violations can have a significant impact on "substantive" compliance. It is also our observation that firm enforcement of technical requirements (as in the case of ECOA) assures the elimination of many of the opportunities creditors might have to discriminate. (For example, information that should not be considered by the creditor will not be available if the creditor is in "technical" compliance.) Similarly, ensuring that disclosures are made routinely helps provide effective" self enforcement (by the consumer) of "substantive" principles.

On the subject of prohibited discrimination, we note that Regulation B makes a valid distinction between "discriminating" and having the "effect of discriminating." Likewise, the determination of either, (particularly the latter), could require adjudicative authority which the agencies may not possess.

Although we have now clarified that our loan review extends to rejected applications, we believe that our procedures have always been geared toward detecting overt discrimination through lending policies and implementation of those policies. When we have encountered them we have identified policies and practices that discriminated (or may have had the effect of discriminating) and ensured that credit union officials made necessary changes.

Finally, we would suggest that Appendix I be corrected to reflect the three additional categories of prohibited discrimination under ECOA. Also the reference to the Preservation of Consumers' Claims and Defenses Act should be to the Federal Trade Commission's Trade Rule.

If you have any questions concerning our comments to your proposed report, please call us. And, again, thank you for your staff's helpful comments in getting our expanded consumer enforcement program underway.

Sincerely,

Lawrence Connell

LAWRENCE CONNELL
Chairman

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

October 24, 1980

Mr. William J. Anderson
Director
General Government Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

We have reviewed your draft of the proposed GAO report entitled "Financial Institution Regulators Need to Focus on Substantive Principles of Consumer Legislation During Compliance Examinations." While we believe that the Office of the Comptroller of the Currency (OCC) has established an effective consumer compliance program, the overall conclusion stated in the title of the report reflects a desirable and necessary requisite, one which OCC has been addressing and continues to address with extensive resources.

We believe that we have made significant progress in alleviating many of GAO's concerns. However, the report contains certain statements and conclusions relating to the effectiveness of the consumer examination process which we believe are inaccurate or in need of clarification.

## GENERAL COMMENTS

The usefulness of the report is limited for a number of important reasons. First, the report appears to view the five financial regulatory agencies as a single regulator, rarely identifying problems or deficiencies that an individual agency may need to address or desirable practices that an agency may need to retain.

We understand that general comments in the report usually do refer to the performance of all of the agencies. However, we also note that the report allocates certain deficiencies to "one" or "some" of the agencies and certain favorable practices to a "few cases" or a "few instances." We cannot easily address those situations without knowing which agency is involved. Moreover, the report is in the present tense although its analysis covers activities and practices that may have already been modified or which are in the process of revision. GAO has indicated that it will provide more specific details, and we look forward to receiving that information.

The report contains an often-repeated conclusion that the agencies' examinations are generally inadequate for determining compliance. However, the report does not define inadequate, nor does it state what would be adequate. It does indicate that the conclusion was based on the agencies' lack of documented analysis, such as comparison of rejected loans to accepted loans, analysis of monitoring information for real estate-related loans and the use of Home Mortgage Disclosure Act (HMDA) data for geocoding to assess compliance with the Community Reinvestment Act (CRA). While documentation of the examiner's analysis is desirable, we believe that it is the analysis itself that is crucial to the adequacy of the examination process.

Elaboration in GAO's report on the meaning of inadequate would further assist us in our current overall review of our procedures. An agency cannot easily devise improved procedures if it is unable to identify undefined inadequacies. We intend our review to include determining what is inadequate. Only then will we be able to identify and improve deficiencies.

Equally important, the report states that the agencies have seldom cited violations of substantive principles of some laws, such as discriminatory practices, but it does not list the specific citations which GAO considers substantive.

We note that some of the conclusions in the report were based on only six on-site examinations or on only one or two incidents. For example, during one on-site examination an examiner did not know how to correctly calculate an annual percentage rate. It does not appear reasonable that such a limited or isolated observation can be extropolated by GAO to apply either to an individual agency or to the agencies in general.

The report does not indicate why an annual percentage rate could not be calculated or what the examiner did to compensate for the deficiency. In some cases, especially where irregular mortgage transactions are involved, calculator limitations prevent our examiners from calculating annual percentage rates. However, they can still either verify the accuracy of the disclosed annual percentage rate or obtain an accurate annual percentage rate from their regional office. The report does not indicate whether the observed examiner pursued any of those available courses of action.

## SENIOR MANAGEMENT SUPPORT

In Chapter 2, GAO states that some examiners or managers who showed a commitment to examining and enforcing legislation said they found little support from top management. This issue is raised again briefly in Chapter 3 where it is stated that regional managers' actions reflect the limited direction they received from the agencies' headquarters. We take exception to these statements. Since 1976, OCC has committed, publicly and internally, significant resources to the consumer compliance area by creating our Office of Customer and Community Programs, significantly improving our consumer training school, and developing a career path for consumer examiners. To reinforce this commitment, and to educate Regional Administrators, senior management and our most experienced commercial examiners on recent developments in consumer legislation, OCC has held compliance conferences in 1979 and 1980 for these key agency personnel.

## EDUCATION

In Chapter 2, GAO states that educational efforts of each of the agencies is helpful. OCC strongly supports this contention and, as in the past, will continue to commit our available resources to provide such education.

Under the sponsorship of various trade groups and others, we have made presentations before over 15,000 members of the financial community and numerous consumer group representatives. OCC's first round of consumer examinations, originally intended to take one year, lasted over two and one-half years because examiners remained in the banks they examined to provide guidance and assistance and, on occasion, to train bank personnel. The *Comptroller's Handbook for Consumer Examinations*, which contains extensive training material, has been provided to all national banks and examiners and to others, upon request. We have also made available for bank use the OCC's *Computational Procedures for Verifying Annual Percentage Rates*, the *Program Guidebook to Help Meet Community Credit Needs*, and numerous other training materials.

## EXAMINER TRAINING

The report states not only that inadequate training of examiners has contributed to the agencies' inconsistent and inadequate examination of consumer law compliance, but that, in most cases, training has been directed more to an understanding of the laws than to the specific examination techniques necessary to discover violations of the laws. We take exception to these comments for a number of important reasons.

Obviously, specific examination techniques would be useless if the examiner had no knowledge of the laws. The consumer, community and fair lending laws are complex and our training has devoted substantial time to explaining the meaning of the laws to examiners who have had virtually no exposure or sensitivity to their requirements. Those same examiners have had experience examining banks. They have learned some useful techniques in the commercial area, particularly with respect to conducting investigations of questionable practices and interviewing bank personnel.

Since early 1979, OCC's consumer training program has devoted a great deal of time to examination techniques. The examiners have been required to conduct a simulated examination in a hypothetical bank. They have been given case studies, have reviewed loan files, have written reports of examination and have reviewed compliance with bank management. Their work has been evaluated for the adequacy of their analysis and accuracy of their conclusions. In addition, after completing their consumer school training, examiners initially conduct consumer examinations with the assistance of experienced consumer examiners. That on-the-job training includes practical instructions on examination techniques.

At the time of GAO's audit, the Federal Financial Institutions Examination Council (Council) was only beginning to legally function. Since the audit, the Council has implemented a number of steps to ensure uniformity among the agencies with respect to consumer compliance enforcement, training and examinations. Examiners from each agency now receive the same formalized classroom training at the Council's recently established interagency consumer training school.

Newly-hired examiners, since June 1980, receive exposure to consumer laws during their initial 6-month on-the-job training period. After additional field experience, each of those individuals is then scheduled to attend a 2-week consumer training school. It should also be noted that our regional offices hold update training for experienced consumer examiners. These examiners are instructed on revised examination techniques, newly enacted legislation and policy matters in the consumer compliance area.

GAO states in Chapter 2 that examiner use of HMDA information ranged from not considering it to analyzing it in comparison with CRA statements to verify compliance with CRA. OCC examiners are taught to: (1) note the information's existence, (2) verify it for technical compliance, (3) analyze it for possible discrimination, (4) compare it with CRA statements and (5) analyze it to determine whether the bank is helping to meet local community credit needs. Although our examiners are trained to fully analyze HMDA data, we will address any on-site examination deficiencies which may be indicated by the detailed data which GAO is to provide us.

## SUBSTANTIVE VS. TECHNICAL NONCOMPLIANCE

The report concludes that the agencies have been able to identify "violations of technical requirements involving forms and disclosures" but that they have seldom cited substantive violations of law, such as discriminatory practices. We have two reservations concerning that apparent criticism. First, we are uncertain about which violations of law GAO considers substantive. Second, we do not know on what basis GAO has determined that substantive violations exist where they have not been cited.

It appears from the report that GAO considers the principle of meaningful disclosure to be a technical requirement. On the contrary, we strongly believe that a number of disclosure requirements, such as those of the Truth in Lending Act (TIL) relating to disclosure of annual percentage rates and finance charges or of the Equal Credit Opportunity Act (ECOA) relating to notification of adverse action and disclosure of joint accounts held by married individuals, are substantive in nature. Since disclosure violations were not included in substantive violation totals, the conclusions regarding substantive violations may very well be incomplete.

## REPEATED VIOLATIONS

We also have general difficulty in understanding the significance or meaning the report attaches to repeated violations of law. The report deals with two basic types of repeated violations. The first pertains to violations which are cited from one examination to the next, but which are either violations of different statutes or different requirements of the same statute. The second type pertains to repeated violations of the same requirement of the same statute.

GAO's observations raise pertinent issues which are not addressed by the report. We are unable to determine whether the repeated violation was technical or substantive. It might be reasonable to assume that violations of complex, technical requirements cannot always be avoided, even by an institution which has clearly demonstrated that it has made significant efforts to ensure compliance. Such efforts can be frustrated by personnel turnover or other factors, such as the introduction of new loan types.

While an institution may have been cited repeatedly for violating the same requirement of the same statute, the report does not determine if the practice giving rise to that violation was the same. For example, an institution may have been cited for disclosing inaccurate annual percentage rates as a result of treating credit report fees incorrectly in connection with automobile loans. At the next examination, the same institution may have been cited again for disclosing inaccurate annual percentage rates, but that time as a result of treating loan origination fees improperly in connection with real estate loans.

## COMPLIANCE DIFFICULTIES AMONG SMALL VS. LARGE INSTITUTIONS

GAO states that information received from several sources indicated that the smaller institutions were generally having greater difficulty implementing consumer credit legislation than were larger institutions. That information is then contrasted with GAO's observation that, except for the Federal Home Loan Bank System, the number of violations reported decreased as average asset size decreased. The report does not appear to draw any conclusion from those conflicting observations and it also does not provide any reason for the differences.

It may very well be that smaller institutions, because they originate less complicated and fewer types of loans, are cited for fewer total violations. For example, many smaller institutions are not even subject to the requirements of HMDA. However, the violations for which smaller institutions are cited are generally of a substantive nature. Smaller institutions are often unable to dedicate the resources necessary for dealing with the complexities of fair lending requirements or annual percentage rate calculations. They can little afford the assistance of legal counsel in their compliance efforts and available personnel are often extensively involved in daily operations.

On the other hand, larger institutions have more numerous opportunities to make technical errors. They can also have greater difficulty ensuring strong internal controls among larger staffs and they experience frequent staff turnover which leaves some operations to inexperienced employees.

## ACCEPTED AND REJECTED MORTGAGE LOAN ANALYSIS

The report indicates that substantive compliance would have been hard to reach because examiners performed very little analysis of accepted versus rejected loans. We recognized long ago that the procedures in use during 1979 and earlier had significant limitations, even when those procedures were properly followed.

We are continually striving to devise examination methods that can increase our level of confidence in examiner determinations. For example, we are now using a much more sophisticated technique to analyze accepted and rejected mortgage loan applications through our computerized Fair Housing Home Loan Data System (12 CFR 27), which became operational on January 1, 1980. Also, our more experienced, senior examiners now participate in the substantive compliance evaluation process.

To supplement our analysis of accepted and rejected mortgage loan files, we will be providing our field examiners with significant guidance on how and when to conduct interviews with contacts outside the bank. We are also reviewing the need for more extensive applications of the "effects test" under Regulation B (12 CFR 202).

## FOCUS OF CONSUMER EXAMINATIONS

In the report, GAO states that because of limited staff, limited expertise, and efforts to maintain a 12- or 18-month examination cycle, the agency field offices encouraged broad but limited examinations of compliance with all consumer laws. It should be noted that, as GAO began their audit, OCC was field-testing specialized consumer examination procedures. These procedures, subsequently adopted by OCC, were originally distributed to consumer examiners at OCC's March 1979 consumer training school.

The specialized procedures always require the examiner to complete the work programs for the Fair Housing Act (FHA), ECOA, CRA and TIL. The procedures also require the examiner to complete all general examination work programs for recently enacted legislation. In March 1979, such legislation included the Electronic Fund Transfer Act (EFTA) and the Fair Debt Collection Practices Act.

For all other consumer laws, such as the Real Estate Settlement Procedures Act or the Flood Disaster Protection Act, the examiner has the option to waive the examination work programs. That option may be exercised only if the bank was found to be in general compliance with those laws during the preceding examination or if the bank adequately corrected violations cited. The specialized procedures deal with the more substantive requirements of those laws.

## ENFORCEMENT

In Chapter 3 of the report, GAO states that "most financial institutions continue to be cited for non-compliance with some portion of these [consumer] laws." While any violation of law should not be completely discounted, it is understandable that institutions have had difficulty complying with consumer legislation.

In view of a number of contradictory court decisions, the numerous regulatory staff letters needed to clarify the complex provisions of some of these laws, and general misconceptions which have existed for years among the institutions and the agencies, it should be expected that it will take a great deal of time to identify and rectify the errors of the past. Additionally, the problem is attitudinal, as well as historical. We believe, however, that our commitment in this area is well known among national banks and those banks are now responding positively to compliance requirements in measurable terms.

Chapter 3 also indicates that the agencies differed on their supervision of "worst-case" institution noncompliance. OCC was described as using stronger transmittal letters and in a few instances, compliance visits. We agree with GAO, for we recognize that increased use of visitations is desirable. OCC has since issued Examining Circular No. 193, dated September 9, 1980, which contains our policies and procedures relating to consumer compliance visitations. These instructions will result in greater use of visitations as a supervisory tool for ensuring compliance with consumer laws.

The report also mentions that financial institutions which do comply are penalized in the sense that they are treated no differently than institutions which do not comply. It further states that institutions generally complying with the laws are examined, a form of regulatory burden, as often as their counterparts which do not comply. In response to these comments, we should first mention that, as a result of recent legislation, OCC is no longer obligated to conduct examinations according to specific calendar periods. We now have more flexibility in our ability to address noncomplying banks and we will be able to allocate our limited resources more efficiently to examine those banks more frequently and in greater detail. Banks with no problems or fewer problems can now be examined less frequently.

Additionally, as indicated above, we will be making greater use of visitations and specialized examination procedures which will enable the examiner to focus on substantive provisions of the laws and on problem areas in the bank. However, we still find it somewhat difficult to acknowledge that financial institutions which did comply during GAO's audit period were penalized, since our records show that most national banks were found to be in substantive noncompliance at that time. In view of those circumstances, virtually all banks had the same priority in the consumer examination area. Thus, we often scheduled consumer examinations on the basis of commercial examination priorities.

## INTERAGENCY UNIFORMITY

The Council and each of the agencies have provided available resources for assisting in the development of uniformity among the agencies. As mentioned earlier, examiners from each agency now attend the Council's interagency school. At the Council's direction, the agencies have developed and adopted a uniform TIL enforcement policy and uniform EFTA examination procedures. Also, the agencies are in the process of developing a uniform FHA/ECOA enforcement policy and uniform examination procedures for TIL, ECOA and the Right to Financial Privacy Act. Although resources are limited, the agencies will continue to make progress in this area.

However, a major problem which confronts financial institutions is only briefly alluded to in the report. Financial institutions continue to be subject to more severe supervision than their competitors. Although a financial institution may choose which regulator it prefers as a supervisor, it cannot avoid periodic compliance examinations. Meanwhile, many thousands of other institutions which are capable of accepting deposit investments or of making loans are not subject to such periodic examinations.

## SUMMARY

OCC recognizes problems inherent in our consumer compliance and enforcement programs. To the extent that GAO's report has further helped us identify such problems we commend GAO's staff. We are addressing these problems and have made significant strides to that end.

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In particular, we have already begun to address GAO's recommendations that we reassess the nature and objectives of consumer law compliance examinations; identify techniques which will assist us in placing greater training emphasis on examination procedures which assess substantive principles of the laws; develop uniform, interagency examination procedures for consumer protection laws; determine the level of resources necessary to implement uniform examination procedures; and define criteria for examination frequency.

However, we believe that no useful purpose can be served by focusing on isolated problems, conclusions reached on the basis of only a few observations or problems not adequately defined. In that regard, we believe it would be inappropriate to place too much emphasis on such areas addressed in the report.

We appreciate the opportunity to submit comments regarding this draft report.

Very truly yours,

John G. Heimann
Comptroller of the Currency

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